



UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

PricewaterhouseCoopers

FINAL REPORT

UKRAINE MASS PRIVATIZATION PROJECT

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INTRODUCTION

BACKGROUND TO THIS REPORT

This report is to serve as the final report on the United States Agency for International Development-funded, Price Waterhouse (PW) (now PricewaterhouseCoopers) Ukraine Mass Privatization Project which began in late 1994 and was concluded in the fall of 1998.

The report is intended to serve not only as a review for USAID and the US government of the accomplishments of the project but to provide the international donor community, the Government of Ukraine and its privatization agency and other parties involved in privatization with a detailed review of Ukraine's Mass Privatization Program – including its successes, challenges and results and impact to date on the industry and economy of Ukraine and recommendations as to future actions to be undertaken by the Government with international donor support (including international donor financing conditionalities).

The individual chapters of the report provide an in depth review of key elements of Ukraine's privatization program and the USAID-funded, PW Ukraine Mass Privatization Project:

- The “Executive Summary” provides a summary of the key issues and accomplishments of the project;
- The “PW/USAID Ukraine Mass Privatization Project” section provides readers with a history of Ukraine's privatization program and the project, a review of the critical issues and key undertakings during each of the four years, 1995 – 1998, of the mass privatization project, a summary of the privatization status of Ukraine's largest and most important (to the economy) enterprises, a review of the agro-industrial privatization program, and an analysis of new initiatives of the government to exert control over Ukraine's key industrial sectors.
- The “Privatization Mechanisms” section of the report provides a summary of the mechanisms by which Ukraine is privatizing its economy and more detailed explanations of the privatization vehicles including certificate auctions, tenders, international tenders, contracts for management of state shares by third parties, share sales via stock exchanges and the OTC market, “mass” cash auctions and the privatization program for small enterprises.
- The next section, “Mass Privatization Project Team”, summarizes the output and accomplishments of the various components of the USAID-funded, PW Mass Privatization Project.
- The final section, “Final Phase Task Order: Key Events and Key Outputs” provides detailed, month-by-month reviews of the Mass Privatization Project team's work since April 1997 (when USAID awarded its final mass privatization consulting contract to PW).

These reports are meant to provide USAID, the international donor community and the Government of Ukraine and their advisors with a practical and detailed analysis as to what has been accomplished to date in privatization of the economy and current issues and obstacles to economic reform. The reports also address what future tasks must be undertaken to assist Ukraine in its transition to a viable market economy able to begin to reverse the country's catastrophic economic decline (a more than 50% drop in real GDP and an equally severe decline in the average standard of living since 1991), to best utilize its substantial industrial capacity, some of the richest agricultural lands in the

world, and a highly educated population of 51 million people for the benefit of its citizens and for the creation of an independent, economically strong nation in Eastern Europe.

BACKGROUND TO THE MASS PRIVATIZATION PROJECT

Price Waterhouse (PW) was hired by USAID to advise the government of Ukraine on the design, development and implementation of the country's program to mass privatize its nearly 10,000 medium and large industrial enterprises under a framework agreed by the international donors (USAID, World Bank, European Union and the EBRD) with the Government of Ukraine in early 1994 and ordered to be implemented by a Presidential decree in November 1994. The donors and the Government agreed on the following general objectives for the mass privatization program:

- “distribute shares rapidly and equitably to the citizens of Ukraine;
- develop capital markets and capital market infrastructure;
- and rapidly create a critical mass of privately owned enterprises to allow necessary restructuring and modernization to proceed under the direction of the new private owners.”

The agreement also stated that “many other economic factors – external to mass privatization – are critical to the success of the privatization program and privatized enterprises. Progress regarding these factors must occur in parallel to mass privatization.”

PW drew on its experience in implementing mass privatization voucher (or “certificate” in Ukraine) auction programs in Russia, Moldova and Kyrgyzstan – and its privatization experience elsewhere in the former Soviet Union and Central Europe – to utilize the lessons learned from these countries to develop a program for Ukraine. PW consultants began working with USAID and the World Bank and Ukraine's Cabinet of Ministers and its State Property Fund representatives in 1993 to develop a new privatization program which was finally adopted by the government of Ukraine in late 1994 and for which implementation began in early 1995.

In line with the donors'/Government of Ukraine's agreement on the framework, USAID's objective for the PW Mass Privatization Project (MPP) was to mass privatize a “massive” number of medium and large enterprises involving “massive” participation by the Ukrainian public. The #1 objective was to transfer ownership of state enterprises from the state to the private sector. This objective was not only economic but very political, i.e. to end state ownership, management, and control of the economy. The generation of revenues for the state budget and the attraction of strategic investors were not the primary objectives.

The project's tasks did not involve any work on “parallel” issues nor post-privatization objectives, e.g. enterprise restructuring, enterprise bankruptcy/liquidation, the development of an environment conducive to entrepreneurship, protection of private sector ownership rights and less onerous and arbitrary taxation, etc. PW was given one overriding task: to advise and assist the Government of Ukraine to transfer ownership of its medium and large enterprises from the state to the private sector as rapidly and transparently as possible.

By way of background, in support of this objective, the PW project team, as senior advisors to Ukraine's State Property Fund and Cabinet of Ministers, was also involved in developing many other aspects of Ukraine's privatization program including drafting of the government's annual privatization programs for approval by the Parliament; drafting of the agro-industrial sector privatization program implementation procedures, drafting of the new tender for advisor and enterprise tender regulations for the sale of large share packages of strategic enterprises to international investors with the assistance of international advisors; drafting of the standard contract for management of state shares by third parties; drafting of the mass cash auction

policies/procedures/software; drafting of the law on the privatization of the telecoms monopoly; and numerous other privatization consulting projects not directly related to mass privatization/certificate auctions.

The PW team was further assigned responsibility by USAID to advise and assist Ukraine's Securities Commission and the State Property Fund in the development of the means to monitor and regulate the activities of investment funds participating in the certificate auction program and to ensure the reliable and transparent registration of the millions of shareholders created through mass privatization and the transfer of shareholder data to independent share registrars. These projects were undertaken with the aim of developing a viable and transparent secondary market for the trading of privatized shares which would foster the development of new strategic and financial investors interested in reviving Ukraine's most promising medium and large enterprises.

There are some observers who would question the efficacy of mass privatization to promote the transformation of Ukraine's economy – versus other possible means of privatization. Why did the international donors and PW promote mass privatization via certificate auctions?

- Mass privatization/the auctioning of shares for certificates freely distributed to the public – versus other possible means of privatization – is the most rapid, equitable, and transparent means of privatization.
- The 25% to 100% of shares in each medium and large enterprise (the smaller the enterprise, the higher the percentage of shares sold for privatization certificates) transferred to employees, the public, financial intermediaries, and strategic investors via public certificate auctions and preferential sales to employees, served as the key factor in “jump-starting” the privatization of such enterprises and in creating a secondary market for trading in the shares so privatized.
- As important, the mass privatization program – with its built-in systems, procedures and regulations to ensure the integrity of the process – ensured massive public participation in the program which in turn promoted public acceptance of the government's privatization and economic reform initiatives.
- The mass privatization certificate auction program took far longer to complete in Ukraine versus other ex-Soviet republics and the countries of Central Europe. However, the sale of remaining state shares of large enterprises by other means (stock exchange offerings, cash auctions and tenders) – following share sales to employees and the public for certificates – has proven to be a much slower and often less transparent means of privatization.
- Case-by-case, negotiated sales of Ukraine's nearly 10,000 medium and large enterprises would have required dozens of years of negotiations with potential investors, leaving the door open to the continuation of the opaque, insider and potentially corrupt means of privatization as practiced prior to the initiation of the mass privatization program in 1995 (when privatization meant the stripping and sale of state assets by insiders and the transfer of billions of dollars to offshore accounts). With a very limited number of potential international investors – and few domestic investors with any capital to invest (excluding of course offshore Ukrainian capital), the government has generated only \$110 million in revenues from tenders, stock exchange sales and cash auctions during the first eight months of 1998 – the most active period of share offerings for cash by the government. Mass privatization has required more than four years to complete. Negotiated sales would require many more years to complete during which time the enterprises would require continued massive state subsidies while gradually sliding into defacto bankruptcy.
- Restructuring of enterprises prior to privatization would have required time and resources (managerial experience and skills) far beyond the means of a government with very limited

financial resources and experience in developing a market economy. And, given the rapidly changing international economic environment, it is unlikely that such restructurings would create enterprises able to compete and survive.

- If the government had opted to sell all medium/large enterprise shares for cash, the results would have been disastrous. As noted above, an essentially “cash-less” domestic economy and little international interest have ensured that cash sales to date (via stock exchange sales, tenders and cash auctions) have generated only \$200 million to \$250 million for the state over the past three and one-half years.
- Rapid, mass privatization has allowed the government to greatly reduce subsidies to state-owned enterprises. “Hidden” subsidies continue but cash subsidies to loss-making enterprises have been reduced by billions of dollars over the past three years.

Mass privatization as practiced in Ukraine has attempted to avoid some of the pitfalls which faced Russia’s mass privatization “voucher” auction program:

1. Enterprise directors are limited to the preferential purchase of only 5% of shares for certificates – plus an additional 5% for cash if they fulfill the conditions of their privatization plans as approved by the State Property Fund. While this has resulted in broadly dispersed ownership of Ukraine’s major industrial enterprises, it has also prevented enterprise directors from easily gaining controlling interests in their enterprises as happened in Russia (Ukrainian enterprise directors may however obtain expanded ownership via the purchase of shares in the secondary market – but this requires that they go to the time and expense, including securing outside financial backing, to undertake such share purchases).
2. Because Ukraine’s mass privatization program took longer to complete than Russia’s program, the interim allowed the government to establish an independent Securities Commission in 1995 and, over the past three years, to develop a legal and regulatory framework to promote the rule of law in corporate governance, shareholder rights and the secondary share market. While implementation has not been ideal, Ukraine has at least provided its regulatory authorities with the powers to promote fair play.
3. As opposed to the situation in Russia, shareholders created through the mass privatization program are covered by regulations governing the registration of share ownership. For example, any enterprise with 500 or more shareholders is required to appoint an independent share registrar with smaller enterprises required to confirm their recording and transfer of share ownership to the Securities Commission.
4. The international donors – particularly the US Government, World Bank and the IMF – have been able to tie their loan conditionalities and technical assistance directly to specific privatization targets which the Government of Ukraine must meet in order to secure such financing and assistance.

The impact of Ukraine’s mass privatization program can be assessed in terms of the following strategic changes to Ukraine’s economy:

- The state has given up ownership of 80% of its industry. While state authorities continue to exert formal and informal influence over the 8000 medium/large enterprises privatized since January 1995, millions of privatized shares will never return to the hands of the state. 18 million Ukrainian citizens have become shareholders and 60% of Ukraine’s labor force work for privatized enterprises.
- While in most cases the directors and managers of privatized enterprises are holdovers from the Soviet era, these people are gradually being replaced by a new generation of directors and managers from the post-Soviet generation.
- In many cases, the new generation of investment fund managers who have become major shareholders via the mass privatization program are putting in place new enterprise directors and

managers to replace the old-guard and to introduce new management techniques which might allow many ex-state enterprises to survive and compete in the post-Soviet economy.

- State budget support for unprofitable enterprises has been greatly reduced since the beginning of the mass privatization program.
- The shares of thousands of privatized enterprises have served as the basis for the development of Ukraine's capital market including the establishment of five stock exchanges and an active over-the-counter trading system.

It should be kept in mind that these accomplishments were undertaken in a very difficult environment:

1. On-going decline in Ukraine's economy which has ensured that most (generally older) citizens remain nostalgic for the Brezhnev era and for (what they believe in hindsight to be) the stability and certainty of life in Soviet times. These citizens, who have seen their standard of living decline precipitously over the past seven years, blame the Government and its reformers for their woes and readily vote for candidates of the Communist and Socialist parties (such candidates are generally lower level Communist party officials from the Soviet era; the ex-party leaders generally now run the Government and industry).
2. A leadership attempting to balance political pressures from Russia to avoid any moves to closer integration with western Europe, NATO and the US with its own interests in pursuing greater integration with the west;
3. A Government generally led by ex-Soviet officials and with only a handful of young, relatively experienced reformers in ministerial and vice ministerial positions. While the Government in principle supports the state's privatization program, most Government officials have been indifferent to the program, failing to provide any leadership to accelerate and secure public support for privatization. Many Ministers and officials in the Cabinet of Ministers have sought all along to promote the vested interests of their respective ministries in order to retain control over large enterprises within their sphere of influence and to sometimes ensure their own enrichment.
4. A Government attempting to create a state where none had ever existed. Ukraine's longest experience as an independent state has been the seven years following independence from the Soviet Union in 1991. Ukraine was essentially run from Moscow during the Soviet era and thus never had the opportunity to create an independent government bureaucracy and state administration.
5. A generally very hostile Parliament dominated by Communists and Socialist Party deputies often strongly opposed to the Government's privatization program. As opposed to Russia, the President's powers are far more limited with the Ukrainian Parliament having the authority to approve all privatization legislation and the annual privatization programs/strategies drafted by the Government.
6. A state privatization agency, the State Property Fund (SPF), caught in an on-going battle between the Government and the Parliament for control over the SPF and Ukraine's privatization program. The result of this politicization of the SPF has been "revolving door" leadership with senior officials not only highly inexperienced in privatization but also afraid to make the necessary decisions to accelerate the privatization program.

The most important impact of Ukraine's mass privatization program has been to hasten the day when the government and industry will undertake the next, and more politically/socially/economically challenging, phase of economic transformation.

As opposed to its neighbor to the northeast, Ukraine does not possess Russia's vast oil, gas and mineral resources which might keep its economy from sliding into bankruptcy.

1. Ukraine possesses a huge Soviet military-industrial oriented industrial economy – which includes hundreds of large military-industrial and supporting enterprises which have been fully or partially privatized - and which has lost its rationale for existence, is no longer economically viable, and cannot be supported by the state.
2. Thousands of other privatized enterprises are not viable. They have remained in business only through state subsidies in the form of below-cost electric power supplies and accounts receivable and accounts payable paid in barter, a means of payment which allows such enterprises to survive only because they do not pay their employees in cash, do not pay taxes and do not maintain financial accounts which reflect their true financial condition.
3. A couple of hundred large enterprises (partially or fully privatized) in the metallurgy, electric power generation and distribution, telecoms, chemical, machine-building, refining, gas pipeline, gas and oil distribution, and shipping industries might survive and compete in a global economy if allowed access to international capital and international strategic investor ownership and management.
4. Ukraine was not only a military-industrial heartland of the Soviet Union but the breadbasket of the Soviet Union as well. While most of Ukraine's farms remain alarmingly unproductive, semi-feudal collective farms, most of Ukraine's agro-industrial enterprises have been privatized. Until land privatization, the break-up of collective farms and the elimination of the state's role in monopolizing the distribution of agricultural production take place, these privatized agro-industrial enterprises will face continued obstacles to developing their full potential.

Ukraine's ex-state/privatized and partially state-owned medium/large industry generally adds no value to the economy. Industry produces products which no one wants to buy for cash and which can only be sold in barter transactions with other partially state-owned - or privatized but heavily influenced by the state - enterprises. In other words, the value of the inputs exceeds the market value of the output of many enterprises. The cash economy represents a very small portion of sales and income by enterprises in the medium/large industrial and agro-industrial sectors. These enterprises survive on the barter of goods at prices which do not represent the devalued value of their output. And they survive through various non-cash subsidies from the government. The problem of course with this "barter" economy is that enterprises have no cash to pay wages and taxes – and continue to survive long beyond their useful lives.

Mass privatization is therefore a key factor in forcing the government, industry and the economy as a whole to begin the very difficult, second phase of restructuring of Ukraine's economy:

- Implementing the formal bankruptcy of one-third to one-half of Ukraine's medium and large ex-state owned enterprises.
- Liquidating and redeploying the viable assets of such enterprises to more productive uses as determined by the new owners of such enterprises.
- Allowing the secondary capital market to allocate new capital to those most promising of Ukraine's ex-state owned enterprises and promoting international investment in such enterprises.
- Introducing laws to allow for the private ownership of land – which will in turn eventually lead to the breakup of Ukraine's feudal collective farming system and growth in the privately owned agro-industrial sector.

- Reducing state budget and non-cash subsidy support for defacto bankrupt state/ex-state owned enterprises and reallocating such funds to provide support for the basic living standards of the most vulnerable of Ukraine's population.

In sum, mass privatization has accelerated the conditions by which the government might begin the second stage of radical restructuring of the economy. We believe that this is unlikely to formally happen soon given the lack of strategic/visionary leadership of the Government of Ukraine and the control of Ukraine's Parliament by reactionary, old-guard forces who will not permit radical restructuring to occur. Thus it is more likely that much of Ukraine's privatized industry – created by the mass privatization program - will “informally” continue its slide into bankruptcy – with new, private sector owners attempting to restructure and make viable the most promising of Ukraine's privatized medium/large enterprises.

Among the “lessons learned” by the PW Mass Privatization Project team:

1. While the project eventually reached its objective of privatizing nearly all of Ukraine's medium/large enterprises, the process could have been accelerated had USAID and the other donors insisted early on that the Government of Ukraine commit to specific, monthly targets in terms of the supply of enterprises to the mass privatization program.
2. While USAID funded the development of the “demand” side of the program (i.e. the printing and distribution of certificates to millions of citizens, the establishment of a network of auction centers to conduct certificate auctions, the development of the legislation, policies, procedures, software, hardware and training of personnel) to carry out certificate auctions, there were few early donor conditions placed on the Government of Ukraine to manage the “supply side” of the program, i.e. to rapidly provide large share packages of hundreds of enterprises for monthly auctions.
3. In general, it is still too early to empirically assess the impact of Ukraine's mass privatization program on the country's medium and large industrial enterprises.
4. The donors should have pushed/should now push for the Government of Ukraine to quickly institute widespread bankruptcy and liquidation of thousands of state-owned/ex-state owned enterprises – while ensuring that the Government allocate scarce resources from support for such enterprises to support for the most vulnerable segments of Ukraine's population.
5. Future donor (IMF, World Bank and US government) financing and technical assistance conditionalities must focus on requirements for the state to reduce its shareholdings to zero in all except perhaps a handful of “strategic” enterprises and to liquidate recently created state holding companies which attempt to manage remaining state shareholdings in major enterprises – by which the Government can continue to exert formal and informal influence over key industries.

NEXT STEPS

The next steps to be undertaken by the Government of Ukraine, steps which will require some continued international donor technical assistance, must be:

- The sale by the state of all its remaining – both large (26% or 51%) and “leftover” (10% or less) - shareholdings in several hundred large enterprises and several thousand medium sized enterprises;
- The use of recently adopted tender regulations by which the State Property Fund might hire international advisors to assist the SPF in the sale of large (25%+) state owned share packages

to international strategic investors in Ukraine's 25 to 50 largest and most viable industrial enterprises;

- The maintenance of the PW/USAID data analysis and research projects and the *Ukraine Privatization and Investment Web Site* which serve as the primary vehicles by which the State Property Fund is able to provide reliable, independently verified privatization data and information to both domestic and international audiences;
- The liquidation of dozens of old and new state-sponsored holding companies in the industrial and agro-industrial sectors;
- The development and implementation of bankruptcy and asset liquidation regulations and procedures for Ukraine's ex-state enterprises;
- Support for enterprise restructuring of Ukraine's most viable industrial enterprises;
- Development of the means for such enterprises to better access international and domestic (including offshore domestic) capital markets;
- The promotion of an environment, tax regime, legislation and a "mind-set" which will encourage the millions of Ukraine's highly educated, potential entrepreneurs to take the risk of starting up new small enterprises.

EXECUTIVE SUMMARY

MASS PRIVATIZATION AND ECONOMIC REFORM IN UKRAINE

Although characterized by numerous delays as a result of a lack of high-level political will and support and political interference and obstacles to implementation at both the national and regional levels, Ukraine's "mass" privatization program has produced very impressive results since its initiation in January 1995. Depending upon the political will of Ukraine's government including the Cabinet of Ministers and the State Property Fund (the government agency responsible for the privatization of Ukraine's economy) - and market conditions - over the next few months, Ukraine should be able to complete the privatization of its approximately 10,000 medium and large industrial enterprises by early 1999.

Completion of the privatization (excluding minority state shareholdings) of Ukraine's 200 largest and most attractive (to international strategic investors) enterprises should be completed by mid-1999.

What is "Mass Privatization"?

Mass Privatization is the "mass" sale (i.e. a large number of enterprises sold rapidly) to a "mass" number of investors (employees and the public) of a large percentage of shares (25% to 100% of each enterprise) in exchange for privatization "certificates" distributed free-of-charge to all citizens. In Ukraine, Mass Privatization involves the universe of the country's approximately 10,000 medium and large industrial enterprises and the distribution of certificates to 90% of Ukraine's 51 million citizens.

Ukraine's Privatization Program: The Framework

Initiated by President Leonid Kuchma's decree of November 1994, Ukraine's privatization program involves the following means of share sales:

1. Small-scale privatization of nearly 40,000 shops and other small retail establishments (so-called "Group A" enterprises, those with fixed assets of less than UAH 1 million - about USD 500,000) has been conducted via lease/buyout to employees and cash auctions and is 95% completed. (Note: Small-scale privatization is not part of the mass privatization program.)
2. Medium/large enterprises (those with fixed assets exceeding UAH 1 million) are divided into three groups: Group B enterprises are those with UAH 1 to 170 million in fixed assets, Group C enterprises are those with a similar range of fixed assets but with a larger ratio of fixed assets per employee (determined by a formula of book value of assets per employee), and Group D enterprises are the largest - those with more than UAH 170 million in fixed assets or monopoly enterprises.
3. Each citizen of Ukraine is entitled to receive one privatization voucher ("Privatization Property Certificate" or "PPC") to exchange for shares in enterprise share auctions. In addition, each citizen who held a bank account as of January 1992 is entitled to receive one or more Compensation Certificates ("CC") - to invest in enterprise share auctions - to compensate for lost savings as a result of past years' hyperinflation. PPCs are registered securities. CCs are bearer securities - which any investor (including foreign investors) -can purchase in the secondary market and invest in share auctions. Distribution of PPCs and CCs to the public was concluded on July 1, 1998.

4. Employees and managers are given initial preferential rights to purchase shares of their enterprises for PPCs. Following preferential sales, remaining shares are sold to the public for PPCs and CCs and to investors for cash and/or future investment commitments based upon enterprise share allocation plans approved by the State Property Fund according to the requirements of the annual Privatization Programs approved by the Parliament..
5. Generally, the smaller the enterprise, the higher the percentage of shares sold for certificates to employees. Thus, the shares of Group B enterprises are generally 100% sold for certificates. Group C enterprises are primarily sold to employees and the public for certificates with leftover shares sold for cash on local stock exchanges and/or in cash tenders.
6. The largest (and generally most attractive) industrial enterprises, the Group D enterprises, have in general sold 25% of their shares to employees and the public for certificates, with the state initially retaining (subject to future sale) 26% or 51% of shares in “strategic” enterprises, and with the balance of 24% to 49% of shares sold via one or more of the following means: cash tender, investment tender, combination cash/investment tender, local stock exchange sales.

1998 Privatization Program

The 1998 Privatization Program, as drafted by the State Property Fund and the Cabinet, approved by the Parliament, and signed into law by the President in February 1998 is among the most progressive and ambitious of Ukraine’s annual privatization programs adopted since independence in 1991.

The 1998 Program extends certificate auctions to the end of 1998, eliminates (for the first time) minimum (book value) or “floor” pricing for all forms of share sales (for certificates, for cash and in tenders), provides for the corporatization of all enterprises - including those officially prohibited from privatization, requires that relevant ministries justify continued state shareholdings in individual enterprises and that the state retain shareholdings in only a limited number of strategic enterprises, guarantees the rights of shareholders, and requires that the state ensure the transparency - through broad publication - of monthly results of the privatization program.

In sum, the 1998 Program - agreed by the Parliament and the President - provides an effective framework for the State Property Fund to essentially complete Ukraine’s privatization program in 1998. The 1999 Privatization Program has been drafted by the State Property Fund and submitted to the Cabinet for review and subsequent submission to the Parliament. While ending certificate auctions, the draft Program provides for the continuation of the progressive aspects of the 1998 Program and provides the basis for both the sale of large state shareholdings in strategic enterprises to international investors and the sale of all small, leftover state shareholdings in thousands of other enterprises via the “mass cash” auction program.

Mass Privatization Objectives versus Cash Sales Objectives

The most common general criticisms of Mass Privatization are that “certificate privatization has produced no positive results”, i.e. that

- ◇ “no significant revenues have been generated for the state budget”
- ◇ “privatization of the largest enterprises has not really begun,”
- ◇ “effective new owners have not been created”
- ◇ “strategic investors have not appeared”
- ◇ “no financial improvements have appeared at the enterprise level”.

Among many Ukrainian officials and citizens, there is confusion between the objectives of mass privatization (accelerated *political* transformation of the economy) and the objectives of cash sales

(*revenue generation* for the national budget and for capital investment in industry). Many officials believe that mass privatization and cash privatization are two separate and contradictory forms of share sales. In fact, they are closely related and are complementary.

Government of Ukraine's Objectives for Mass Privatization

In 1994, the Vice Prime Minister and the Minister of Economy, on behalf of the Government of Ukraine, and officials of the World Bank, the United States Agency for International Development and the European Union, on behalf of the international donors, signed a Memorandum of Understanding to govern Ukraine's mass privatization program. This set forth the commitments of the government of Ukraine to implement the mass privatization program and the commitments of the international donors to provide technical and financial assistance for the program.

In the Memorandum, the government of Ukraine agreed to the following general objectives for the mass privatization program:

"The objective of mass privatization in Ukraine is to (1) distribute shares rapidly and equitably to the citizens of Ukraine, (2) develop capital markets and capital market infrastructure and (3) rapidly create a critical mass of privately owned enterprises to allow necessary restructuring and modernization to proceed under the direction of the new private owners." (The Memorandum also states that "many other economic factors - external to mass privatization - are critical to the success of the privatization program and privatized enterprises. Progress regarding these factors must occur in parallel to mass privatization.")

The government of Ukraine's decision in late 1994 to begin a mass privatization program was based on a realistic assessment of the country's situation and on a general vision among Ukraine's leaders as to the path of reform to be pursued:

- ◇ state-ownership, state management and official corruption had resulted in political mismanagement of the country's resources and the eventual collapse of the Soviet economy,
- ◇ "privatization" of Ukraine's industry, as practiced in the early 1990's (prior to the mass privatization program), had been in the form of "spontaneous" privatization whereby the *nomenklatura* was involved in the widespread appropriation of state assets,
- ◇ recovery and growth would require radical new initiatives to create an environment which encourages competition, investment and risk-taking by the private sector while discouraging official corruption,
- ◇ and that Ukraine's future lies in a liberal, market economy with expanding ties to new markets, outside Russia, in Europe and other regions of the world.

Ukraine's reformers also realized that accelerated economic reform and the completion of a mass privatization program would require, more than anything else, a high degree of *political will* on their part. In other words, Ukraine's leaders would be required to *fight an on-going political battle with those parties most interested in maintaining the status quo* or increasing the role of the state in the economy.

Opposition to privatization appears from many different constituencies:

- * state-owned enterprise managers (and holdover managers in ex-state-owned enterprises), bureaucrats in the branch ministries, and politicians who do not want to lose their privileges and control over state assets;
- * reactionary politicians who have yet to realize that it is impossible to "turn back the clock" to a state-owned/command economy;
- * "entrepreneurs" who have reaped large and questionable profits from their business connections and cooperation with political leaders and state-owned enterprise directors;

- * and older citizens and the most vulnerable segments of the population who realize that they might lose their jobs, that they do not have the skills to compete in a market economy and that the government is unlikely to provide sufficient social welfare benefits to sustain them during the transition to a market economy.

Why “Mass Privatization”?

Based upon the experience of other countries which had earlier initiated the transition to a market economy, Ukraine’s reformers understood that mass privatization offered the only opportunity for rapid, broad-based, in-depth structural reforms of the economy.

With sufficient political will by leaders at the highest levels of the government, Ukraine’s reformers understood that implementation of a mass privatization program could succeed in producing such structural reforms because:

- 1) Mass privatization, with the participation of millions of enterprise employees and millions of citizens, is the most transparent, efficient and rapid means of transferring control rights over the assets and cash flows of Ukraine’s industry from the government to the private sector. *The accelerated transfer of the ownership of Ukraine’s economy from the state to the private sector is the single most important objective (and result) of mass privatization.*
- 2) The basic assumption behind this objective is that government/political ownership of industry results in unproductive, uneconomical, non-market oriented, corrupt, and “political” management of industry - and ultimately to industrial mismanagement and industrial decline. *Mass privatization is the single most rapid and efficient means of “depoliticizing” ownership of the economy.* There is nothing more important to the success of Ukraine’s reforms.
- 3) *As government ownership and management of industry disappears, new, private sector investors - who are willing to accept the risk of losing their capital in exchange for potential returns, are encouraged to become enterprise owners.* Not only do such new owners invest their capital, they work hard to ensure a maximum return on their investments. And a maximum return requires that these new owners replace existing, often incompetent (and often corrupt) directors, restructure production by expanding those most profitable and promising business lines while discontinuing unprofitable business lines, develop new marketing strategies and new markets for their products, retrain employees, create enterprises better able to compete in both the domestic and international markets and enhance share value for their shareholders.
- 4) With ownership transfer from the state to the private sector and with new owners and managers of formerly state-owned enterprises, *conditions are created for the government to play a new role in the economy:* not as an owner of industry but as a regulator to promote an optimal environment for the development and growth of the private sector, for the promotion of entrepreneurship by the public, for the rule of law over property rights and business contracts, for the encouragement of investment through a reduction in both bureaucratic interference with business and onerous taxation, and for *the creation of a general climate in which government promotes rather than discourages the private sector.*
- 5) *Workers, managers, the public and financial investors will actively respond to economic incentives and opportunities - as provided through the mass privatization program - to become shareholders* in their own enterprises, in attractive enterprises with which they are familiar and in enterprises which they believe might best prosper in a market economy.

- 6) Mass privatization (preferential share sales to employees and certificate auctions to the public) of the shares of Ukraine's largest and most attractive enterprises is the most effective, rapid and transparent means by which privatization of such enterprises is initiated and by which employees and managers (and the public) become long-term investors in and supporters of the privatization and restructuring of their own enterprises. *Mass privatization is the first stage in the privatization of large, attractive enterprises and provides a base of employee and broad, public shareholder support for major new shareholders and owners* - i.e., financial investors who purchase shares in cash auctions and strategic investors who acquire majority shareholdings through cash/investment tenders. Thus, mass privatization is not incompatible with cash sales and tenders but, in fact, serves as the basis for successful future cash sales and the attraction of new capital investment by strategic investors.
- 7) Mass privatization is one of the most transparent, competitive and accelerated forms of privatization with shares sold on an objective basis to bidders offering the highest number of certificates. The process of selling shares through the mass privatization program is therefore the ideal model for sales of shares for cash and via tenders for strategic investors. Transparent and competitive procedures for cash sales and investment tenders are an effective means of attracting domestic and international financial and strategic investors to Ukraine's privatization program. *It is therefore critical that Ukraine's sales of remaining large or majority share packages in its strategic enterprises employ the transparency and the non-subjective, competitive and accelerated aspects of the mass privatization program* (while avoiding non-transparent, uncompetitive and time-consuming forms of privatization such as "non-commercial" tenders and case-by-case/negotiated share sales).
- 8) *The final major reason behind the government of Ukraine's decision to implement the mass privatization program in early 1995 was the understanding by government reformers that the rapid and broad distribution of shares to millions of new shareholders quickly creates improving conditions for:*
- the development of a large and active secondary securities market for the trading of shares in privatized (as well as newly established, privately owned) enterprises,
 - the acquisition of large shareholdings in Ukraine's promising privatized enterprises by strategic and financial investors who provide new investment in plant and equipment and who exercise their shareholder voting rights to initiate changes in management, production, marketing programs, training and utilization of employees, and other strategies which will generate long-term, sustainable growth and profitability for such enterprises in a competitive, market economy,
 - the liquidation of uncompetitive, unpromising and bankrupt enterprises and the redeployment of their assets to more productive and profitable uses,
 - the ability of promising enterprises - which have been restructured by their new, private sector owners - to pay wages and benefits to their employees, to pay their electric bills, to pay taxes and, in general, to serve as financial contributors to their workers, their communities and the government,
 - and the ability of the government, with increased tax revenues from expanding and profitable enterprises and with reductions in state subsidies to industry, to utilize scarce state budget revenues to support the most vulnerable segments of society: workers who are temporarily unemployed as a result of the bankruptcy and liquidation of enterprises, pensioners, and those who are unable to care for themselves.

In practice of course, privatization is always a “messy,” complicated and very political process. The benefits of enterprise restructuring and the inflow of new investment capital do not occur immediately after privatization. The tangible benefits of privatization depend to a great extent upon the government’s (with the active participation of the private sector) ability to create a supportive environment for the growth and expansion of the private sector, e.g. less bureaucracy, reduced tax burdens, a transparent and equitable regulatory regime, land privatization, the protection of investor and shareholder rights, the rule of law, the implementation of enterprise bankruptcy and liquidation procedures for failed enterprises, and the development of effective market mechanisms to allocate capital to the most promising of Ukraine’s ex-state enterprises. At the same time, experience proves that, if the leadership of Ukraine focuses on rapidly accomplishing the objectives of mass privatization while addressing the “environmental” issues, new investment, enterprise restructuring, and the revival and growth of Ukraine’s economy will follow.

PROGRESS TO DATE

The USAID Mass Privatization Project has contributed to one of Ukraine’s most successful reform initiatives. Despite tremendous political and economic obstacles over the past nearly four years, the Project has implemented - with the State Property Fund and the Cabinet of Ministers of Ukraine - a massive transfer of the ownership of Ukraine’s industrial sector from the state to the private sector.

While the next/second phase of reform (i.e. bankruptcy and liquidation of the thousands of unviable ex-state medium and large enterprises and the allocation of domestic and international capital – and new owners/managers - to those most promising “survivors”) has yet to be implemented, the first phase – the transfer of ownership from the state to the private sector – has essentially been completed:

Enterprises Privatized

- 8150 medium and large industrial enterprises (out of a universe of an estimated 10,000 enterprises) have been privatized (“privatized” is officially defined as >70% of shares sold) since the beginning of the mass privatization program in January 1995.
- 1850 medium/large enterprises are currently undergoing preparation for/conducting share sales.

Shares Sold for Certificates

- More than 50% of all shares sold - of the 8150 medium/large enterprises privatized since January 1995 - have been sold through certificate auctions to employees and the public - for Privatization Certificates (PPC’s) and Compensation Certificates (CC’s), a clear indication of the critical role certificate auctions have played in the accelerated privatization of Ukraine’s largest enterprises.
- 6500 enterprises have sold shares in PPC auctions, offering 12,300 share packages.
- 4700 enterprises have sold shares in CC auctions, offering 7000 share packages.

Value of Shares Sold

- The face value of shares sold to date in the enterprises which have participated in PPC and CC auctions is approximately US\$12 billion.
- The market value of such shares sold to date is US\$1.6 billion.

Certificate Collection and Investment by the Public

- 90% of the public collected their PPC’s (46 million citizens x 1 PPC per citizen).
- 41 million PPC’s have been invested to date.

- 28% of CC's available for distribution to citizens were collected of which 50% have been invested to date.

New Shareholders Generated via Certificate Auctions

- An estimated 35% of Ukraine's citizens have become shareholders through the mass privatization program.

Privatization of Ukraine's Largest Enterprises

Of Ukraine's 200 largest enterprises (including those currently prohibited from privatization and those which were privately established/never state-owned):

- 78% are subject to privatization,
- 70% have begun share sales,
- of which 101 have sold more than 25% of their shares,
- including 61 which have sold more than 50% of their shares,
- including 44 which have sold 75% to 100% of their shares.
- These enterprises include Ukraine's largest and most important - to the economy - metallurgy, chemicals, electric power, machine-building and heavy industrial enterprises.
- 121 of these enterprises have participated in certificate auctions.
- The 22% of enterprises on the "top 200" list which are prohibited from privatization are nearly all in the telecoms, railroad, and atomic power sectors.
- 5% of the largest 200 enterprises are privately-owned and were never owned by the state.

Privatization of Ukraine's Strategic Industries

Privatization of the Electric Power sector is well underway:

- The State Property Fund and the Cabinet of Ministers have approved all the privatization plans/share sales allocation plans for Ukraine's 27 regional electric power distribution companies and four generating companies, providing for state shareholdings of 25%+1 share in the distribution companies and 50%+1 share in the generating companies.
- For each enterprise, up to 30% of shares are to be sold to employees and the public for PPC's and CC's, up to 13% of shares are to be sold on local stock markets, and up to 40% of shares are to be sold for in cash tenders or in international tenders.
- All 27 electric power distribution companies have completed preferential share sales to employees for PPC's of which 22 have sold shares in PPC auctions, including 10 which have sold up to 36% of their shares in commercial (cash) tenders and 22 which have sold up to 13% of their shares on local stock exchanges.

Privatization of the Agro-Industrial Sector

- Of the 5000 medium/large agro-industrial enterprises currently in the privatization program, 4900 have begun share sales - of which 4200 have sold more than 70% of their shares.
- 443 grain processing, storage and distribution enterprises, which until recently belonged to the Khliv Ukrainy ("Bread of Ukraine") state grain sector monopoly and which represent some of Ukraine's largest agro-industrial enterprises (grain elevators), are undergoing privatization.

"Privatized" Labor Force

- More than 50% of Ukraine's total labor force is employed by medium and large industrial enterprises which have been privatized since 1992.
- An additional 20% of Ukraine's labor force is employed by medium and large enterprises which are in the process of privatization (i.e. have to date sold < 70% of their shares or have yet to begin share sales).

- Thus, by completion of the Mass Privatization Program in 1998, at least 70% of Ukraine's labor force will be employed by privatized (formerly state-owned) enterprises.
- The balance of the labor force is employed by enterprises not currently approved for privatization (railways, telecoms industry, atomic power plants) and by enterprises which are privately-owned (i.e. never state owned/established post-independence).

With the exception of the telecoms, railway, and atomic power industries (which are on the Parliament's privatization "negative" list), all other industries in Ukraine have been privatized or are in the process of privatization. The government has approved a draft privatization plan for the state telecoms monopoly, "Ukrtelecom". This plan will be introduced to the Parliament for its consideration in September 1998 including the removal of the telecoms sector from the negative list.

The critical issues for the next phase of Ukraine's privatization program are:

- The sale of major (25%+) state retained shareholdings in hundreds of "blue chip" – or semi-viable – enterprises and the sale of thousands of small, "leftover" state shareholdings in thousands of ex-state enterprises.
- The liquidation of the dozens of new state holding companies created over the past couple of years. The state, at the initiative of the ex-Soviet bureaucrats, is attempting to use retained state shareholdings in "blue chip" enterprises to create new state-sponsored holding companies (which are to be privatized for the benefit of GOU insiders) – all of which helps to defeat the objective of mass privatization, i.e. the elimination of the state's role in running the economy.
- The "mentality" behind the creation of these new state holding companies will, unfortunately, not be eliminated until the next – post-Soviet – generation takes over the management of government and industry.

World Bank EDAL II Tranche 1 loan privatization conditionalities (as described below) were met by the Government of Ukraine/State Property Fund as confirmed during the World Bank Mission's meeting with the management of the SPF on June 25, 1998. This is a significant accomplishment considering the obstacles which have had to be overcome by the GOU/SPF - and the donors who have assisted the program - over the past four years.

At the same time, it should be recognized that achieving the Tranche 1 conditionalities was a very long and arduous process. The targets were achieved long after the originally agreed deadlines between the GOU and the international donors. And these achievements were achieved primarily as the result of a very major investment in technical assistance by USAID and the leveraging of World Bank and IMF financing conditionalities.

All parties (including SPF management) agree that the Tranche 2 and 3 conditionalities, particularly those relating to the overall number of enterprises (70%+) privatized, privatization of the grain sector monopoly, and the sale of 51% share packages in strategic enterprises to international investors will be difficult to attain by the end of 1998/early 1999.

However, the SPF/GOU are following plans (developed by the USAID consultants) to privatize 8500 medium/large enterprises (since January 1995) by September 30, 1998 and 9500 by the end of 1998. It should be noted that the SPF/GOU has already exceeded the Tranche 3 World Bank conditionality for the number of such enterprises 100% privatized.

For several months, we have been trying to get the SPF to develop and implement month by month plans to reach the overall IMF/WB/USG privatization target of 9500 medium and large enterprises 70%+ privatized (since Jan 1995) by the end of 1998 as well as the donors' ex-Khlib Ukrainy

enterprise privatization targets. (Note: The EDAL II Tranche 3 target for the number of enterprises 100% sold has already been exceeded.)

With our assistance, the SPF is implementing monthly share sales plans to reach 8500 enterprises sold by the end of September. 7800 enterprises were 70%+ sold (including 4900 100% sold) as of the end of July - with an average of 170 reaching 70%+ sold per month since February. About 350 per month are planned to reach 70%+ sold during August - December, including 1000 to be sold during the 4th quarter.

With Mr. Bondar's recent return to the SPF as acting Chairman, he has taken an aggressive role in pushing the SPF to reach the donors' 9500 conditionality by year end. He recently signed an Order which requires that the Regional Property Funds add enterprises to their monthly "plan graphics" which will allow the SPF to reach the overall target.

The SPF is also under orders from the Prime Minister and the Cabinet of Ministers to offer as many share packages as possible for cash. The SPF has therefore reallocated medium/large enterprise share packages from planned offerings in certificate auctions to cash auctions ("mass cash" auctions, offerings on stock exchanges/the OTC market, dutch auctions).

The World Bank's Tranche 1 conditionality of 150 grain marketing and distribution enterprises to begin share sales, of which 40 are to be privatized, has been met. But this has been accomplished primarily through the hands-on, enterprise-by-enterprise consulting and privatization training seminars provided by the 15 to 20 full and part-time USAID-funded agro-industrial privatization consultants. Post-September, with the conclusion of this technical assistance, it is expected that results will slow considerably.

Among the grain sector universe of enterprises, the privatization of the 442 ex-Khlib Ukrainy enterprises is the highest priority as these grain elevator enterprises are the most strategic in the grain sector.

Another concern is with regard to the conducting of international tenders for advisors to conduct tenders for the sale of large (26% to 51%) share packages in 25 to 50 of Ukraine's most promising strategic enterprises. While the SPF and the GOU have approved new tender for international advisors and international tender regulations, they have yet to be utilized.

***GOVT OF UKRAINE PROGRESS TO DATE (AS OF AUGUST 31) VERSUS
WORLD BANK EDAL II PRIVATIZATION CONDITIONALITIES***

- #1 7500 Medium/Large Enterprises (MLE) to be 70% privatized since Jan 1, 1995 for 1st Tranche (8500 for 2nd Tranche, 9500 for 3rd Tranche):
8150 MLE 70%+ privatized to date.

- #2 3750 MLE to be 100% privatized for 1st Tranche (4250 for 2nd Tranche, 4750 for 3rd Tranche):
4900 MLE 100% privatized to date.

- #3 50 “giant” enterprises (Ukraine’s very largest, defined by the GOU as those with more than UAH 170 million in fixed assets) - out of a universe of 200+ privatizable giants - are to each reach 40%+ privatized for 1st Tranche (60 for 2nd Tranche, 100 for 3rd Tranche):
72 “giants” have each been 40%+ privatized to date, including 41 giant enterprises which are 70%+ privatized, including 17 giant enterprises which are 100% privatized.
- #4 150 grain marketing and distribution (GMAD) enterprises to begin share sales for 1st Tranche (300 for 2nd Tranche, 450 for 3rd Tranche):
295 GMAD’s have begun share sales to date (including 270 ex-Khlib Ukrainy grain elevators).
- #5 40 GMAD’s to be 70%+ privatized for 1st Tranche (60 for 2nd Tranche, 100 for third tranche):
130 GMAD’s (including 110 ex-Khlib Ukrainy grain elevators) have sold 70%+ shares to date.
- #6 For 1st Tranche, complete the drafting of regulations providing for transparent tender procedures for the selection of (international) advisors and for the conducting of tenders (for international investors in strategic enterprises):
Both Regulations were officially registered by the Ministry of Justice on July 3, 1998 and can be utilized by the SPF once implementation procedures are completed.
- #7 For 1st Tranche, preparation for 10 tenders to be initiated with share allocation plans providing for at least 51% of shares to be offered to investors. (For 2nd Tranche, complete preparations to begin 3 international tenders using new international advisor tender regulations; for 3rd Tranche, 3 such international tenders to be in negotiation stage and preparations begun for 10 additional tenders):
- **More than 10 tenders (using existing “commercial” and “non-commercial” tender regulations) for strategic enterprises (e.g. energy distribution companies) have been conducted to date.**
 - **Two tenders for international advisors (using the December 1997 tender for advisors regulation) have been conducted to date for the sale of large share packages in two major electric generating companies, Donbasenergo and Tsentrenergo. Negotiations between the advisors and the SPF over contract terms continue.**
 - **Preparation for additional 8 international tender candidates has not been initiated.**
 - **No strategic enterprises have share allocation plans providing for the tendering of 51%+ of shares (i.e. share allocation plans for these enterprises generally provide for 20% to 30% of shares to be offered via tenders).**

IMF EFF Loan Privatization Conditionalities:

The IMF privatization conditionalities are less comprehensive than those of the World Bank. The IMF conditionalities are focused on overall number of medium/large enterprises privatized and privatization of the Khlib Ukrainy (grain elevator) monopoly.

The IMF medium/large enterprise privatization (since January 1995) target is 9500 by the end of 1998 (which builds off the Bank's agreement with the SPF/GOU on targets of 8500 by the fall and 9500 by the end of 1998):

- Both targets can be met by the SPF.

The IMF conditionalities for the privatization of the Khib Ukrainy grain monopoly are as follows:

- The IMF requires that 350 ex-Khib Ukrainy enterprises have approved share allocation plans by June 15, 1998. 367 plans have been approved to date.
- The IMF requires that 100 ex-Khib Ukrainy enterprises be privatized by June 15, 1998. 110 have been privatized to date. All 443 ex-Khib Ukrainy enterprises can be privatized by mid-1999.

Other Major Developments:

Tenders for Electric Power Distribution Companies

In the strategic electric power sector, there were several major developments during July 1998:

Seven (out of 10 concluded to date) cash tenders for large share packages (percent of shares sold indicated below) were concluded in July for the following regional electric power distribution companies ("oblenergos"):

SumyOblenergo, 36%

ChernigivOblenergo, 35%

PrikarpattyaOblenergo, 35%

OdesaOblenergo, 35%

LvivOblenergo, 35%

LuhanskOblenergo, 36%

PoltavaOblenergo, 35%

Each winning bidder has been offered the option of negotiating a contract with the SPF to manage the 25% state share package in each oblenergo. We have initiated discussions with the SPF regarding the use of the newly drafted Management Contract as the model for use in place of the SPF's current seriously flawed (and unused to date) management contract.

The bidding period for these tenders was extended from 30 days to 60 to 90 days, giving potential bidders additional time to conduct due diligence.

Per a Cabinet of Ministers Resolution of August 5, 1998, the state shareholdings in all Oblenergos have now been reduced from 51% to 25%+1 share. The ex-state share packages have been allocated to cash tenders. Meaning that investors will have the opportunity to buy from 35% to 45% of the shares of each Oblenergo in cash tenders – in addition to the 30% to 35% of shares which strategic investors might purchase via local stock exchange sales and in the secondary market.

1999 Privatization Program

The management of the SPF requested our assistance in drafting the 1999 privatization program. During the last week of August 1998, a draft 1998 Privatization Program was completed and approved by the SPF. The draft – which must be approved by the Parliament – calls for the continuation of progressive measures to ensure the completion of the privatization of Ukraine's economy by the end of 1999. Certificate auctions are proposed to end in December 1998. Leftover state share packages will be sold in "mass cash" auctions and "dutch" auctions – with no floor prices.

"Ukrtelecom" Privatization

Our draft of the Law on the Privatization of Ukrtelecom, which had been informally agreed with the State Communications Committee, has been revised in the version informally adopted (i.e. it still requires review by the Cabinet's legal department and the signature of the Prime Minister) by the Cabinet of Ministers for presentation to Parliament in the fall of 1998.

On the positive side, the Cabinet's draft does provide for at least 25% of shares to be sold to a strategic investor, for the preferential sale of shares to Ukrtelecom's 130,000 employees for cash (the use of privatization certificates will end on December 31), for other share sales via stock exchanges and cash auctions, and requires an international audit and valuation of the company prior to privatization.

On the negative side, the Cabinet's draft (while allowing for the sale of 100% of shares ex-one share), includes a state "golden share". The conditions attached to the golden share allow the state to appoint a minimum of 50% of the members of the Supervisory Board and the Revision (audit) Commission – no matter what the size of the state's shareholding and to veto any "national security" related decisions of the Board.

It is very likely that the Parliament will prepare its own Ukrtelecom privatization law and that the final version adopted by the Parliament will be an amalgam of the interests of the Cabinet and Parliament.

"Mass Cash" Auction Results

The results of Ukraine's first Mass Cash Auction for the sale of leftover state shares via the Auction Center Network: 1900 firm bids, all share packages offered were sold, UAH 2.47 million received (UAH 245 million in privatization revenues for the budget have been generated in total by the SPF in 1998 through mid-July). Unofficial results for the second Mass Cash Auction indicate that all share packages offered were sold but that only UAH 600,000 in revenues were received.

NEGATIVE DEVELOPMENTS

While the GOU is progressing toward the completion of the privatization of all state-owned enterprises, including Ukraine's largest and most attractive "blue chip" enterprises, the state continues to retain substantial shareholdings in hundreds of major enterprises. With few exceptions, these state shareholdings must be reduced to zero.

The state continues to undertake new initiatives to exert control and influence over the economy by creating new state agencies and state holding companies which impede the development of a market economy. .

In addition to the continued formal and informal influence of Khib Ukrainy ("Bread of Ukraine") over the strategic grain sector, various ministries are creating new state monopolies to exert control over strategic enterprises in the agro-industrial and strategic industrial sectors. For example, the GOU is promoting the transfer of large share packages in some of Ukraine's most attractive industrial enterprises to two state-owned investment companies – "Finprom" and "Derzhinvest" – creating in effect two new "mega" state holding companies. The managements of these companies are now implementing plans to privatize the companies – which will create ex-state monopolies owned and managed by GOU insiders.

These developments indicate that the international donors must not only pressure the GOU to generate positive privatization numbers, but also to halt the GOU's "back door" formal and informal

efforts to create new state agencies and holding companies which in effect prevent full privatization of the economy while creating new opportunities for official corruption.

History of Ukraine's Mass Privatization Program

Privatization of Medium/Large Enterprises: 1992 - 1994

The privatization program from 1992 through 1994 primarily involved lease buyouts by employees and managers of medium and large-sized enterprises. Shares of some of these enterprises were also made available to the public who could invest via a privatization account scheme organized by the SPF. However, due to the complexity of the account program, a general lack of public understanding of the process and the limited number of enterprises available, during 1993/94 less than 15% of the public took advantage of the opportunity to open privatization accounts and less than 5% actually invested the "funds" (i.e. de-materialized privatization certificates) in their accounts in share auctions. Between independence and the end of 1994, only 1240 medium/large enterprises were privatized, through lease buyout with limited public participation.

Preparing for a Restructured Mass Privatization Program: the 1994 Memorandum of Understanding

In the fall of 1993 donor advisors began to provide technical and financial assistance to develop and implement a public education program in Ukraine as a precursor to the country's mass privatization program. This program involved a multi-media, grassroots public awareness program to introduce the concepts of economic reform, the market economy and privatization to the 51 million citizens of Ukraine.

Beginning in early 1994, a small team of advisors began working with the donor group (USAID, World Bank, TACIS and EBRD) who in turn worked jointly with the Cabinet of Ministers, the State Property Fund (SPF) and other Ukrainian government agencies in an attempt to develop and streamline the government's foundering privatization program.

On February 28, 1994, representatives of the Government of Ukraine, USAID, the World Bank, EU/TACIS, and the EBRD jointly signed a Memorandum of Understanding (MOU) with the Government of Ukraine (GOU), represented by Vice Prime Minister Landyk and Minister of Economy Shpek, which pledged joint international donor support for the GOU's privatization program.

The GOU agreed to the following general objectives for the mass privatization program:

"The objective of mass privatization in Ukraine is to (1) distribute shares rapidly and equitably to the citizens of Ukraine, (2) develop capital markets and capital market infrastructure and (3) rapidly create a critical mass of privately owned enterprises to allow necessary restructuring and modernization to proceed under the direction of the new private owners."

The Memorandum also stated that "many other economic factors - external to mass privatization - are critical to the success of the privatization program and privatized enterprises. Progress regarding these factors must occur in parallel to mass privatization."

The MOU declared that the donor organizations would provide the following technical assistance and financing to implement Ukraine's mass privatization program:

EU/TACIS:

- preparation and assistance in implementing the privatization of 150 medium/large enterprises,
- supporting the privatization process in Zaporozhye oblast.

USAID:

- streamlining and integrating the mass privatization process including assistance in the creation and organization of the national and regional bid centers. This will include provision of software and hardware for the bid collection network and the telecommunications linkages of bid centers in support of the system of mass privatization,
- design and printing of privatization certificates in material form as proposed by the GOU,
- implementing a public information campaign (both prior to and after introduction of privatization certificates in material form to be initiated immediately),
- implementing mass privatization in regions (oblasts) specified by the GOU in consultation with USAID.

The World Bank:

- methodological and legal assistance to accelerate the privatization of leased enterprises,
- equipment including computers, copiers, facsimiles and other necessary equipment to implement the mass privatization system for privatization bodies,
- implementing mass privatization in one region (oblast) specified by the GOU in consultation with the World Bank,
- participation in the public information campaign,
- pilot privatization in Dnipropetrovsk and Donetsk.

The 1994 MOU further stated that the World Bank will provide training to officials in all aspects of privatization. USAID will provide assistance for the development of the institutions and procedures to support a viable securities market and a regulatory framework. EBRD will provide post-privatization investment support. The MOU stated that the donors - collectively - would contribute \$30 million to the first four to six months of implementation of the mass privatization program in Ukraine.

Initiation of the Restructured Mass Privatization Program

In October of 1994, the President issued Decree #699, implementing a new privatization program to involve a “mass” number of enterprises (8000 medium and large industrial enterprises) to be rapidly privatized through “mass” public participation, overriding Parliament’s July 1994 “moratorium” on privatization. In response, donors began funding a major mass privatization project to provide the SPF with technical assistance and financing to develop and implement a nationwide privatization.

In late 1994, mass privatization advisors began their tasks by organizing a team of 150 expatriate and Ukrainian specialists to work jointly with the SPF, the Cabinet of Ministers and other Ukrainian government counterparts. During 1995, the following tasks were completed by this team:

- ◇ Drafted the strategic, legal, policy and procedural framework to initiate the new mass privatization program,
- ◇ Organized the printing of 48 million privatization certificates and their nationwide distribution to the public through the state Savings Bank,
- ◇ Arranged the refurbishment and equipping of sites and the recruiting and training of several hundred Ukrainian personnel to operate 26 auction centers (one per oblast), a national auction center headquarters in Kyiv and 2000 “mini” auction centers throughout the country which collected certificates and bids for shares from citizens,
- ◇ Implemented monthly auctions of the shares of medium and large enterprises beginning with pilot auctions in February 1995,

- ◇ Developed a capital markets team to monitor the activities of more than 200 financial intermediaries (investment funds and trust companies) which are participating in the share auctions and to advise agencies of the government of Ukraine on regulation, monitoring and enforcement for the country's new secondary securities market in the shares of privatized enterprises,
- ◇ Audited certificate distribution, the conduct of share auctions and the use of donor funds by all auction centers, the auction network headquarters, the Savings Bank and the bid collection sites with audit reports provided to the SPF and the auction centers' managements,
- ◇ Developed the software and purchased and deployed the hardware (more than 500 items of non-expendable property including computers, servers, printers, copiers, modems, telecommunications equipment, several hundred computers and a nationwide satellite telecommunications system) for the conduct of auctions by the national auction center network,
- ◇ Designed and established a national consolidated shareholder registration database to record share ownership by individuals and financial intermediaries generated through the certificate auctions,
- ◇ Provided on-going strategic advice to the SPF and the government on means to accelerate and further streamline Ukraine's privatization program,
- ◇ Coordinated these initiatives to accelerate the program with the World Bank, USAID, IFC, IMF, TACIS, the British Know-How Fund and the other donor agencies in order to present joint and common proposals and recommendations to the government,
- ◇ Provided corporate governance training to several hundred enterprise directors and shareholder rights seminars to several thousand citizens.

The efforts of the SPF faced on-going obstacles throughout 1995 which impeded rapid implementation of the mass privatization program including a Parliament which was generally opposed to many of the initiatives of the President and the Cabinet, a bureaucracy which delayed the introduction of proposals to accelerate the supply of enterprises to the certificate auction program, and enterprise directors and regional officials who did not want to speed-up privatization. As a result of these obstacles, far fewer enterprises completed the mass privatization program in 1995 than the government and the donors had earlier planned.

Following completion of the establishment of the certificate auction network during the second quarter of 1995 and the conducting of several auctions, it became clear by the fall of 1995 that the SPF, its regional branches and the government of Ukraine were unable or unwilling to generate a sufficient volume of enterprises to enter the mass privatization process (preferential share sales to employees - and share auctions to the public - for certificates). In other words, donors had financed and developed the "demand" side (and the sales vehicle) for the mass privatization program but the GOU was unable to meet its obligations on the "supply" side. As a result, the donor agencies sent a joint letter identifying obstacles to rapid privatization (highlighting enterprise supply/pipeline problems) to the Prime Minister outlining an action plan, implementation of which would be necessary in order for the government to continue to receive donor technical assistance and credits tied to privatization performance.

A general agreement by the GOU to work with the donors to implement the action plan and establish a framework to accelerate privatization, led to the decision in late 1995 to renew (although at reduced levels) technical and financial support for implementation of Ukraine's mass privatization program in 1996. In early 1996, the mass privatization project thus changed its focus to devote more of its consulting resources to advising and assisting the SPF, its regional offices and individual enterprises to accelerate the preparation of enterprises for share sales and to better plan monthly auctions. At the same time, the project organized share auctions, with no nominal value/floor price, for Compensation Certificates which were printed at U.S. expense and which began to be distributed

in February 1996 to those citizens who held savings accounts whose value was destroyed by the hyperinflation of the prior four years. The first auction for Compensation Certificates was held in April 1996.

Accelerated Mass Privatization during 1996

With these new initiatives, more active support by the Cabinet of Ministers for accelerated privatization, more active leadership by the management of the SPF to better direct the work of the SPF's regional offices, and joint pressure by the international donors, the pace of mass privatization began to accelerate in early 1996. 1996 represented a major turnaround from the poor results for 1995:

- The number of enterprises which offered shares in privatization property certificate (PPC) auctions more than doubled over the total for 1995. 2658 new enterprises offered a total of 4323 share packages in PPC auctions in 1996 *versus* 1292 new enterprises which offered 1873 share packages in 1995. In addition, 1912 new enterprises offered shares in Compensation Certificate auctions in 1996.
- As a result, the number of enterprises privatized (>70% shares sold) during 1996 was 3236, more than twice the number (1015) privatized during 1995.

Agro-Industrial Enterprise (AIC) Privatization

With the passage in 1996 of the "Law on Peculiarities of the Privatization of the Agro-Industrial Complex," the privatization of AIC enterprises changed. Although in general the privatization principles are similar to those for industrial enterprises, certain significant differences appeared.

For AIC enterprises, 51% of the enterprise's shares are distributed free of charge to up to dozens (for the largest AIC enterprises) of suppliers (i.e. collective/cooperative farms), each of which concludes a separate contract with the State Property Fund on the transfer of ownership of the shares allocated to the supplier (takes up to four months).

Next, employees and management are given an opportunity to purchase shares on preferential terms. The percentage of shares allocated to employees and management varies from 5% - 40%, on average, though, this share allocation is 30%. Preferential share sales (for certificates) to employees are allowed to run for one year.

If unsold shares remain after preferential sales, they may be sold in certificate auctions (for PPC's and/or CC's) or cash (via stock exchanges, mass cash auctions, local dutch auctions and/or tenders).

The state may retain shares in "strategic" enterprises - including AIC enterprises - for up to five years. Recent share allocation plans for Ukraine's most attractive grain elevators, for example, include a 25%+one share holding reserved for the state.

For the largest AIC enterprises, share allocation plans generally include an allocation for stock exchange sales and/or tenders. If such allocations are included in the share allocation plan, these cash sales are conducted in parallel with free transfer to suppliers and preferential sales to employees.

Slowdown and Acceleration in 1997

Following the success of 1996, it was recognized in early 1997 - having passed the halfway point in

privatizing 8000 medium/large enterprises (the principal target agreed between the GOU and donors) - that the “pipeline” of medium and large enterprises beginning share sales each month was rapidly declining and that the GOU’s privatization targets would not be met. The passage by the Parliament of a new Law on Compensation appeared to promise citizens cash compensation for inflationary losses and essentially halted citizens’ collection of Compensation Certificates. New enterprise share allocation plans being approved by the SPF and the Cabinet (in the case of large, “Group D” enterprises) provided for smaller share packages to be offered for certificates, with larger packages to be offered in often non-transparent tenders and large packages to remain in the hands of the state.

In sum, as Ukraine’s largest and most attractive enterprises completed preparation to begin share sales through mass privatization, the GOU appeared to be wavering in its commitment to rapid privatization via certificate auctions to employees and the public. The trend appeared to be, instead, toward sales of large share packages in the “best” and largest of Ukraine’s industrial enterprises to “insiders” with the state retaining very large share holdings in nearly all such enterprises. This trend was exacerbated by a number of other political developments which served to greatly “politicize” the privatization program and slow it down and to intensify the rivalry between the GOU and the Parliament. This included the Parliament’s adoption of a new Law on Privatization which, among other things, moved oversight of the SPF from the government to the Parliament; the Parliament’s rejection of the President’s proposed candidate for SPF Chairman; the Parliament’s halting of the sale of strategic enterprises via investment tenders.

1998

At the end of 1997, the donor community were confident that the SPF/GOU would - continuing the accelerated pace - complete the mass privatization of all of Ukraine’s medium/large industrial enterprises (except large agro-industrial/grain sector enterprises) by late 1998. The privatization of small scale enterprises was drawing to a successful close with over 40,000 of estimated 45,000 small enterprises in private hands. There was also optimism the GOU would introduce new tender procedures for large share packages in its largest, strategic enterprises in order to attract international advisors to conduct tenders for international investors. Further, in February the Verkhovna Rada adopted the 1998 Privatization Program which contained several new, positive features to accelerate certificate privatization.

However, with the GOU’s drive to generate cash from privatization and a renewed politization of the privatization program in early 1998, the mass privatization program and the introduction of new international tender regulations quickly ran into new difficulties. In the first half of 1998, the mass privatization program - in terms of overall medium/large enterprise privatization targets - greatly slowed.

Mass Privatization Results: January 1995 to June 1998

Certificate Auctions: The “Locomotive” of Ukraine’s Privatization Program

- As of the end of 1995, only 727 medium/large enterprises were reported by the SPF as having been privatized (70%+ sold).
- As of mid-1996, only 1800 enterprises were reported privatized - with only 11% of the shares privatized for certificates via the mass privatization program.
- As of late June 1998, 7684 medium/large enterprises have each been 70% to 100% sold (including 4777 enterprises 100% privatized) since January 1995.

- Approximately 50% of the shares of these 7684 privatized enterprises were sold for certificates via the mass privatization program.
- More than 10 times the number of medium/large enterprises have been privatized as of mid-1998 versus the end of 1995.

The percentage of shares sold for certificates increased from 11% of total shares sold - to 50% of total shares sold - over the past two years.

Enterprises Privatized: 7600 medium and large industrial enterprises (out of a universe of a approximately 10,000) have been privatized* since the beginning of the mass privatization program in January 1995. In addition, 1240 medium/large enterprises were privatized prior to 1995 primarily through lease-buyout by employees and management - with limited public participation through privatization deposit accounts. The latter accounts were utilized in share sales for only a few hundred enterprises. 2000 medium/large enterprises are currently undergoing preparation for/conducting share sales but may only be sold if new life is brought to the program.

Shares Sold via Certificate Auctions: Nearly 50% of all shares sold - in the 7600 medium/large enterprises privatized since January 1995 have been sold through certificate auctions. These have been sold to management, employees and the public for Privatization Certificates and Compensation Certificates. 6330 enterprises have sold shares in PPC auctions. 4335 enterprises have sold shares in CC auctions.

Value of Shares Sold: The value of shares sold to date (in terms of the nominal value of certificates invested) in the enterprises which have participated in certificate auctions is nearly US\$11 billion. The estimated market value of such shares sold to date is US\$1.5 billion (approximately one-tenth the nominal value). Market value of shares sold is calculated by multiplying the ratio of market value of a PPC (trailing three-month average) to nominal value of PPC times the nominal value of the shares sold for each given auction.

“Privatized” Labor Force: According to Ministry of Statistics data for the 1st Quarter of 1998: there are 9551 medium and large industrial enterprises in Ukraine of which 7388** (77%) are classified as privatized. These privatized enterprises account for 62% of Ukraine’s industrial production and employ 5 million people or more than 50% of Ukraine’s industrial employment.

Certificate Collection and Investment by the Public: 90% of the public have collected their PPC’s (46 million citizens x 1 PPC per citizen). 41 million PPC’s have been invested to date. 28% of CC’s available for distribution to citizens have been collected of which 50% (47 million) have been invested to date.

New Shareholders Generated via Certificate Auctions: An estimated 35% of Ukraine’s citizens have become shareholders through the mass privatization program.

* the definition of “privatized” has, since the 1994 MOU, been accepted to mean that 70% or more of a company’s shares are owned by the private sector.

** This is below the number indicated by SPF data which shows 7,600+ privatized between January 1995 and the present with an additional 1,240 privatized before 1995. We offer no explanation for the discrepancy but believe that the labor figures from the Ministry of Statistics are a reasonable approximation nonetheless.

***UKRAINE MASS PRIVATIZATION PROJECT:
1995 PROGRESS VERSUS OBSTACLES***

Progress to date (since January 1995 start-up):

- 48 million privatization certificates printed and delivered to Kiev.
- Expat advisors (specialists with experience in privatization program development and implementation in Eastern Europe, Russia, Moldova, Kyrgyzstan, elsewhere; auction center network operations; mass privatization policy; audit; auction software/telecoms/hardware/shareholder database; SEC financial intermediary monitoring/regulation; corporate governance training; financial reporting/controls/project administration) mobilized and deployed in Ukraine.
- “Ukrainization” (i.e., development of Ukrainians to assume project management responsibilities) implemented with reduction of expats from 30 in January to 19 currently to 10+/- early next year.
- Ukrainians recruited, trained and deployed to assume responsibility as State Property Fund advisors; regional auction center/regional SPF advisors; to develop privatization policies and procedures for the SPF; to conduct audits of certificate distribution and auction center operations for the SPF; to develop auction software and to install computer and telecoms systems for the auction center network; to monitor the activities of financial intermediaries for the SPF, MOF and SEC; to conduct corporate governance training for privatized/privatizing SOE's; and to manage the financial operations and administration of the project team. The number of Ukrainian professionals recruited and trained has increased from 0 to 115 currently.
- 27 auction centers (one per oblast plus two in Crimea) - plus a national auction network headquarters - were located, refurbished and opened and nearly 1000 Ukrainians trained to operate and manage the auction centers.
- 350 data entry, admin and shareholder database computers installed in the national auction center network.
- 1000 bid collection sites (one per rayon) opened and trained to collect bids, allowing citizens to participate in the mass privatization program without leaving their neighborhoods.
- Certificates collected/privatization accounts opened by 24 million citizens representing nearly 50% of the population (thus producing pressure on a grassroots level for acceleration of the mass privatization program).
- 1287 medium/large enterprises (out of total 7987 approved for mass privatization) offered in ten certificate auctions held since the first “pilot” auctions in February.
- 21 regulations governing the mass privatization program drafted, approved and enacted. Mass privatization regulations essentially completed and operative.
- An agro-industrial law which would have taken nearly half of the approved (by the Cabinet of Ministers) nearly 8000 medium/large enterprises out of the program was vetoed by the President. An alternative law or decree is being developed which would significantly streamline the agro-industrial mass privatization process.
- A “step-by-step” enterprise privatization preparation guide (including closed subscription and valuation) drafted, approved and is being distributed to several hundred enterprises.

- Financial intermediaries database developed to monitor and analyze the investment activities of investment funds and trust companies.
 - Audits conducted of 22 regional auction centers (including regional bid collection sites) covering their bid processing, equipment usage and financial operations. Audits conducted of 11 regional Oshchadny (Savings) Bank (who distribute the certificates) operations regarding certificate distribution procedures. Audits have confirmed 100% compliance with USAID computer equipment and financing guidelines.
 - Temporary shareholder registration system (software/hardware) and regulations and procedures created and being implemented through the auction center network.
 - USAID/PW financing agreement recently signed with the auction center network. The agreement requires the auction centers to devote staff and systems resources to the joint preparation (with the regional SPF offices) of enterprises for auctioning and provides for performance-based compensation of auction center personnel. The objective is to focus resources on significantly expanding the auction enterprise pipeline.
 - Developed a database (the largest single source of information on Ukraine's capital markets) containing information on 309 investment funds, 345 trust companies, 393 broker/dealers, 9 pension funds and 3 SRO's.
 - Monthly financial intermediary activity reports, an investment funds/trust companies compliance manual, a corporate governance practices analysis, a proposal for a public information center, a proposal for self-regulation of the Ukraine securities industry, a disclosure guide (distributed to 300 financial intermediaries), and a quarterly survey of Ukraine's capital markets prepared for the SPF, the new State Securities Commission, and the MOF. A number of specific capital markets reports have also been prepared at the request of the GOU. Training provided to the SPF re financial intermediary monitoring. Training, organizational/strategy and regulatory advice provided to the commissioners of the new State Securities Commission.
 - Corporate governance training provided to 346 enterprise directors throughout Ukraine via a "train the trainers" program.
 - Shareholder rights seminars conducted in 100 cities/towns/villages for 7000 citizens via a "train the trainers" program.
 - The project team has tightly controlled expenditures in line with the volume of enterprises going through the mass privatization program. Only 27% of the USAID project budget utilized during the first half (3 months) of the current task order. Auction center network funding controlled to coincide with level of activity (e.g., auction center network expenses = 22% of budget to date).
-

PW/USAID team proposed the following to USAID in August:

- The PW/USAID team has put in place the Ukrainian personnel, regulations, infrastructure and systems needed for an accelerated mass privatization program which can complete the privatization of nearly 8000 medium/large enterprises by the end of 1996.
- To accelerate the program, the donors must jointly press the leadership of the GOU to assume an active role in promoting the program by eliminating political obstacles to implementation. The mass privatization program must assume a higher priority amongst the leadership. Although Parliament remains opposed to privatization, there is much the leadership can do to accelerate privatization.

- As a result of this proposal, the donors jointly delivered a detailed action plan to the Prime Minister in September. To implement the plan, the SPF - along with representatives of the donors and their consultants - have formed task forces which have been working over the past several weeks to remove impediments.
- High level political pressure from the donors must continue.

1996 UKRAINE MASS PRIVATIZATION CERTIFICATE AUCTIONS

- RESULTS & CONCLUSIONS -

EXECUTIVE SUMMARY

The objective of this report is to provide a consolidated view of the results of and issues pertaining to the Certificate Auctions conducted by the State Property Fund of Ukraine (SPF) and the Ukrainian Center for Certificate Auctions (UCCA) during 1996. The report covers auctions for both PPCs and CCs and consists of two major sections: 1) results; and 2) analysis/issues.

RESULTS

Consolidated auction results for 1996 are as follows:

<i>Indicator</i>	<i>PPC Auctions</i>	<i>CC Auctions</i>
Share Packages Offered	4323	2112
New Enterprises Offered	2669	1912
Average % of Statutory Fund Offered (per auction)	23.95%	16.36%
Average % of Statutory Fund Sold (per enterprise)*	25.08%	17.91%
Winning Certificates*	11,210,093	10,773,277
Total Value (UAH) of Shares Sold*	595,506,915	170,206,798

** Through PPC Auction #22 and CC Auction #7 (both November 1996, the most recent auctions for which results were approved)*

ANALYSIS

The most significant findings of the report include the following:

INVESTMENT PECULIARITIES

...PPCs

- **The Top 10 enterprises generated 21.45% of all invested PPCs.**
- **The Top 100 enterprises generated 60.81% of all invested PPCs.**
- The Top 10% of enterprises (376) generated 80.96% of all invested PPCs.
- Only 1% of all invested PPCs was generated by the bottom 1541 enterprises.
- The five industries which accounted for the highest number of PPCs invested included petroleum processing, metallurgy, trading, strip mining, and coke chemical.
- When measured according to the auction demand coefficient (=number of invested PPCs/number of PPCs needed to sell all offered shares), the most popular enterprises on PPC auctions were in the information technology, chemical/ pharmaceutical, road construction, food processing, and metallurgy industries.

...CCs

- **The Top (1) enterprise generated 16.87% of all invested CCs.**
- **The Top 10 enterprises (0.66%) generated 33.88% of all invested CCs.**
- **The Top 100 enterprises (6.59%) generated 64.05% of all invested CCs.**
- The Top 10% of participating enterprises (152) generated 71.31% of all invested CCs.
- Only 1% of all invested CCs was generated by the bottom 458 enterprises.
- The five industries which accounted for the most CCs invested included coke chemical, hotels, oil/chemicals processing, trading, tractor machine building, and steel construction.

POSITIVE TRENDS

- 1996 totals for share packages offered for PPCs were 230% of 1995 figures.
- 1996 totals for new enterprises offered for PPCs were 206% of 1995 figures.

- 1996 saw a 79% increase in the number of winning PPCs over the previous year and an 88% increase in the number of bids submitted.
- In 1996, enterprises sold on average 77.37% of their offered shares, while in 1995 this figure was 45.62%.
- **CC auctions have offered an effective means of selling shares left over from PPC auctions as well as additional shares, raising the total average sold packages to more than 45% of the statutory funds of enterprises participating in both PPC and CC auctions, while PPC auctions alone account for an average of just over 25%.**

NEGATIVE TRENDS

- Since September 1996, the number of new enterprises entering the monthly auction process has decreased to a low of 154 in January 1997 (lowest since January 1996).
- A similar decrease in the total number of share packages offered has led to the lowest total (347 in January 1997) since July 1996.
- The average percentage of enterprise statutory funds being offered has decreased from 32.90% (January 1996) to 20.22% (January 1997), an all-time low.
- **When measured in PPC equivalents (to avoid distortions introduced by the mandatory indexation of assets), the January 1997 auction saw the lowest total percentage of offered shares since the first PPC auction in February 1995.**
- November 1996 saw the lowest total of winning PPCs (635,283) since October 1995.
- Similar downward trends have been found in CC auctions.

CONCLUSIONS

- ⇒ The certificate auction system continues to represent an effective means of selling to the public shares in state-owned enterprises, especially since the introduction of CC auctions.
- ⇒ The vast majority of certificates are “absorbed” by a small number of popular (“quality”) enterprises/industries.
- ⇒ The Mass Privatization Program has begun to witness several negative trends.
- ⇒ **Only a sharp increase in the number of “quality” enterprises offered and a sizable increase in the percentage of shares offered for auction can counter these negative trends and allow the SPF/UCCA to continue building on the overall success of the 1996 auctions.**

1996 UKRAINE MASS PRIVATIZATION CERTIFICATE AUCTIONS

- RESULTS & CONCLUSIONS -

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1. Introduction

1996 marked a significant departure from recent years, in that implementation of Ukraine's Mass Privatization Program (MPP) occurred with increasing speed and efficiency. During this year, the State Property Fund of Ukraine (SPF) conducted twelve national auctions for Privatization Property Certificates (PPCs) (#s 12-23), commenced regional auctions for PPCs, and launched a new type of national auction for Compensation Certificates (CCs) (#s 1-9)². Throughout the year, the SPF and the Ukrainian Center for Certificate Auctions (UCCA) have gathered volumes of data pertaining to these auctions. This information primarily concerns details on share packages offered for auction as well as the general auction results.

This report is written with the objective to consolidate and summarize this data, to analyze it, and to draw conclusions/identify trends which may have a lasting and important impact on the conduct of certificate auctions in 1997. All information discussed in this report was obtained from the UCCA and SPF. For illustrative and comparative purposes, data on auctions from 1995 had also been included in this report.

² An auction is said to have taken place in 1996 if it was started during 1996

2. General auction results

2.1 PPC auctions

During 1996, twelve PPC auctions (#s 12-23) were held. Each auction had a bid collection period of one month, beginning on the first day and ending on the last day of the month. The table below highlights some basic figures regarding the number of share packages proposed at these auctions as well as comparable indicators for 1995.

Table 2.1.1. Enterprise participation in PPC auctions (1995-1996)

Indicator	1996				1995			
	Total	Auction average	Max	Min	Total	Auction average	Max	Min
Share packages auctioned	4323	360.3	431 (A20)*	135 (A12)	1873	170.3	344 (A7)	56 (A1)
First round enterprises	2669	222.4	314 (A16)	129 (A12)	1293	117.6	190 (A2)	56 (A1)

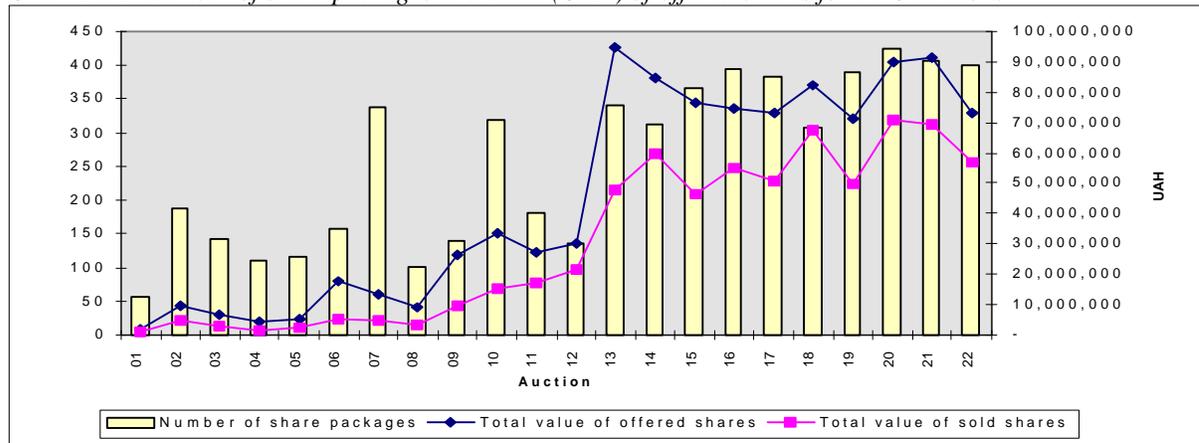
*) the auction number where this maximum or minimum value was reached

Following is a breakdown by the number of times an enterprise has participated in PPC auctions. For Auctions 1 to 23:

- 7 times: 1 enterprise
- 6 times: 2 enterprises
- 5 times: 13 enterprises
- 4 times: 88 enterprises
- 3 times: 335 enterprises
- 2 times: 1232 enterprises
- once: 2291 enterprises

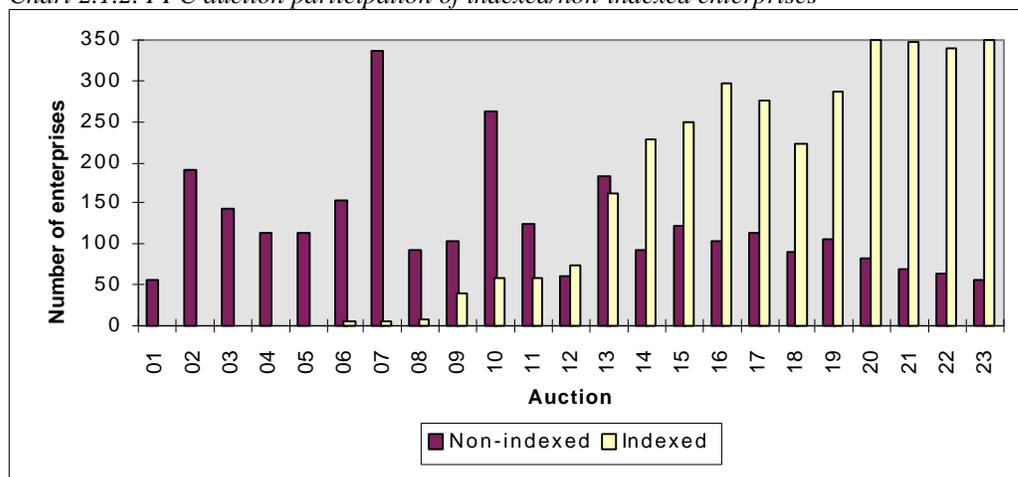
Tables A2.1.1 and A2.1.2 (attached) show additional details respectively pertaining to the supply of share packages to PPC auctions and to the sold share packages with a breakdown by auction. In 1996 the average (for each auction) number of share packages and of new enterprises has nearly doubled compared to 1995. However, because of a continuous decrease in the average size of the packages (both in terms of a percentage of the statutory capital and in absolute value), the total value of the offered shares did not increase considerably. The following chart illustrates the number of share packages offered for auctions, their total value, and the value of the shares sold (in hryvnas).

Chart 2.1.1. Number of share packages and value (UAH) of offered shares for PPC auctions



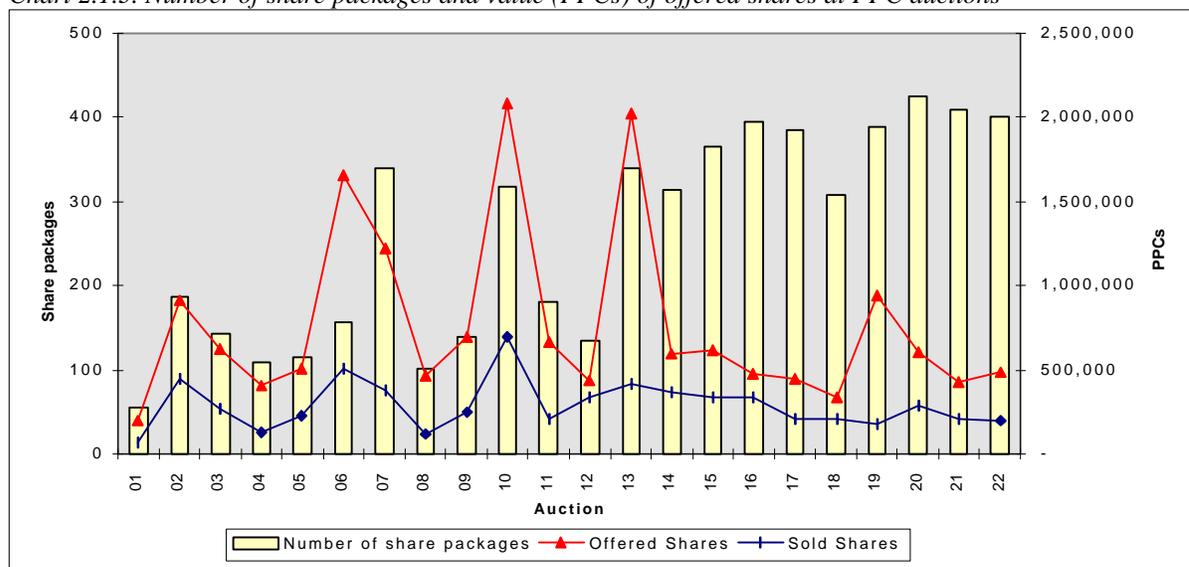
The chart suggests that the value of offered/sold shares increased along with the number of share packages. The reader should take into account, however, that this increase resulted primarily from a rising ratio of share packages of enterprises which were indexed as of January 1, 1995. As the chart below indicates, in 1995, the share packages were predominantly of non-indexed enterprises, while in 1996 indexed enterprises made up the majority of those participating in auctions. This succinctly and objectively explains the increase in the value of offered share packages.

Chart 2.1.2. PPC auction participation of indexed/non-indexed enterprises



In order to determine the real dynamics in value of offered/sold shares, it is most convenient to measure the size of offered share package in their PPC equivalent³ (PPCs). The chart below presents again the number of share packages and value of offered/sold shares, but now measured in terms of their PPC equivalent.

Chart 2.1.3. Number of share packages and value (PPCs) of offered shares at PPC auctions



As we can see, with the exception of few spikes, the value of the offered/sold shares has remained at fairly stable levels for most of 1995-1996. The value of the sold shares is more

³ For non-indexed enterprises: one PPC = 10.5 UAH; for indexed enterprises: one PPC = 500 UAH

constant, although this pattern does follow that of the value of offered shares, albeit with more moderate exceptions. Tables A2.1.3 & A2.1.4 (attached) contain more details on the number of submitted and satisfied bids/certificates (by auction). The auction volume data is listed in the table below.

Table 2.1.2. Auction volume (1995-1996)

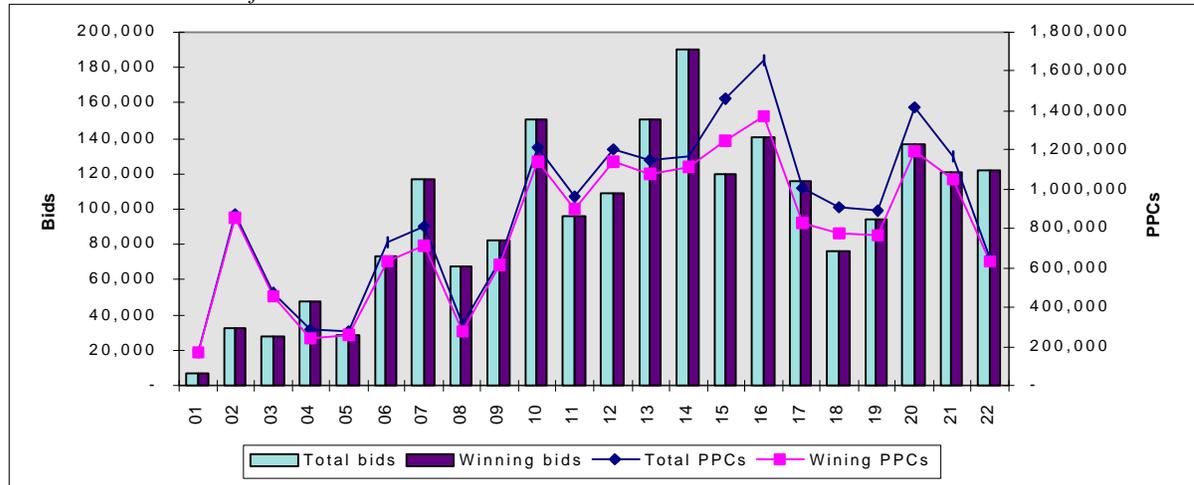
Indicator	1996*				1995			
	Total	Auction average	Max	Min	Total	Auction average	Max	Min
Total number of bids	1,374,707	124,973.4	190,223 (A14)	76,185 (A18)	730,496	66,408.7	150,373 (A10)	7,149 (A1)
Bids from individual bidders	1,367,602	124,327.5	189,506 (A14)	75,626 (A18)	727,775	66,161.4	149,823 (A10)	7,105 (A1)
Bids from financial intermediaries (FI)	7,105	645.9	743 (A15)	546 (A17)	2,721	247.4	550 (A10)	44 (A1)
Bids of type "A" from FI	1,491	135.5	232 (A15)	66 (A18)	631	57.4	86 (A10)	25 (A8)
Winning bids "A" from FI	859	78.1	138 (A15)	34 (A18)	481	43.7	68 (A7)	16 (A7)
Total submitted PPCs	12,674,889	1,152,262.6	1,658,964 (A16)	652,348 (A22)	6,746,143	613,285.7	1,215,261 (A10)	171,556 (A1)
Total PPCs submitted by individual bidders	1,367,602	124,327.5	189,506 (A14)	75,626 (A18)	727,774	66,161.3	149,822 (A10)	7,105 (A1)
Total PPCs submitted by FI	11,307,287	1,027,935.2	1,518,800 (A16)	531,478 (A22)	6,018,369	547,124.5	1,065,439 (A10)	164,451 (A1)
PPCs with bids of type "A" from FI	2,640,842	240,076.5	444,368 (A16)	111,586 (A12)	1,826,833	166,075.7	502,461 (A2)	49,855 (A5)
Total winning PPCs	11,210,093	1,019,099.4	1,375,578 (A16)	635,283 (A22)	6,250,447	568,222.5	1,144,787 (A10)	165,621 (A1)
Winning PPCs from individual bidders	1,367,602	124,327.5	189,506 (A14)	75,626 (A18)	727,774	66,161.3	149,822 (A10)	7,105 (A1)
Winning PPCs from FI	9,842,491	894,771.9	1,235,414 (A16)	514,413 (A22)	5,522,673	502,061.2	994,965 (A10)	158,516 (A1)
Winning PPCs with type "A" bids	1,220,568	110,960.7	174,162 (A15)	51,334 (A12)	1,539,897	139,990.6	486,418 (A2)	22,832 (A11)

*) excluding results of the 23rd PPC auctions (not available at time of writing this report)

Note: the numbers used in the table above and in following tables, concerning auction results will account for those share packages with auction results approved by the auction commission to date.

The majority (>99%) of bids are submitted by individual bidders. However, the PPCs submitted by individual bidders (one PPC per bidder) account for only 12% of the total number of PPCs invested. Thus, financial intermediaries exercise the greatest impact on the trends and tendencies of the PPC investment process.

Chart 2.1.4. Number of bids and invested PPCs at PPC auctions



The chart on the previous page draws the correlation between the number of bids and the number of invested PPCs. Although most of the bids come from individual bidders and most of the PPCs are invested by financial intermediaries, there is a perceptible similarity between these two indicators. It is reasonable, therefore, to assume that both the number of PPCs invested by individual bidders and the number of PPCs invested by the financial intermediaries are conditioned by the same factor. Based on general investment mentality, it is fair to say that the size and attractiveness (in economic terms) of auctioned enterprises are the most likely contributors to the investment decision-making process.

The Auction Commission did not approve the auction results for all offered share packages. However, as Table 2.1.3 shows, only a marginal number of share packages have had their auction results postponed for an undetermined period of time. The major reasons for postponing the auction results approval are the errors that are identified in the enterprise data, published in the auction information note.

Table 2.1.3. PPC auctions results approval

Indicator	Number of enterprises	
	1996	1995
Results approved	3862	1845
Results approval postponed	56	28
Results not approved (A23)	405	
TOTAL	4323	1873

2.2 CC auctions

CC auctions were launched by the SPF in April 1996. Altogether during 1996, nine CC auctions were conducted. Each auction had a bid collection period of one month (except for the first and second CC auctions, which lasted slightly longer than one month), beginning on the 15th and ending on the 14th of each month. To date, the Auction Commission has approved results for the first 7 CC auctions. Table 2.2.1 displays some general figures pertaining the number of share packages offered at CC auctions.

Table 2.2.1. Enterprise participation in CC auctions (1996)

Indicator	Total	Auction average	Max	Min
Number of new share packages auctioned	2112	234.7	342 (A6)	65 (A1)
Number of new enterprises auctioned	1912	212.4	323 (A5)	65 (A1)

Of the 1912 enterprises that participated in CC auctions, 1812 previously participated in PPC.

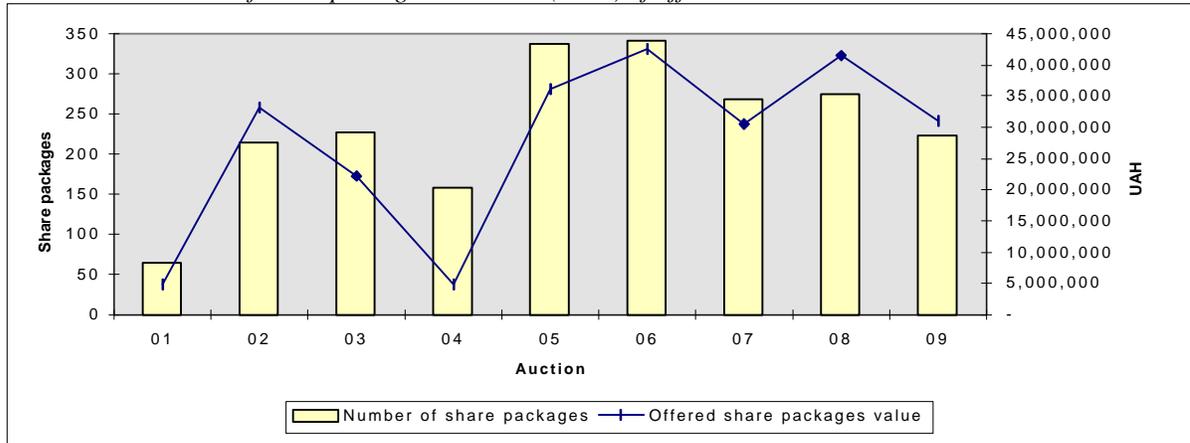
Each enterprise participated on average in 1.1 CC auctions. Following is a breakdown by the number of times an enterprise has participated in PPC auctions. For Auctions 1-9:

- 3 times: 4 enterprises
- 2 times: 192 enterprises
- once: 1716 enterprises

The relatively low level of repeated auction participation is explained by the CC auction regulations, which provide for a complete sale of the share package even if there is very little demand, i.e., no bottom price for shares. Tables A2.2.1 and A2.2.2 (attached) contain more details on the proposed and sold share packages from all 9 CC auctions. And the

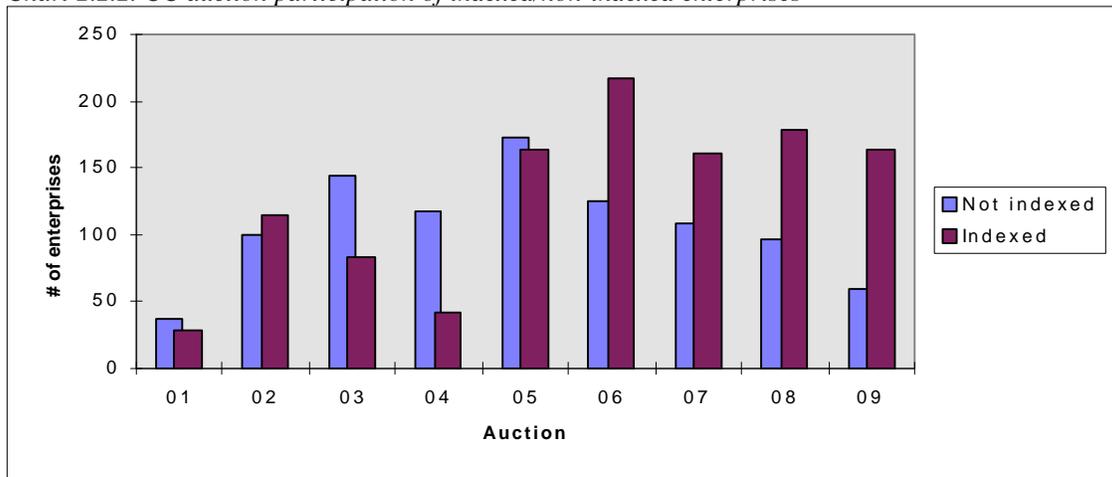
following chart shows the total value of offered and sold shares at CC auctions as well as the number of offered share packages (by auction).

Chart 2.2.1. Number of share packages and value (UAH) of offered shares at CC auctions



The value of supplied shares has been more or less stable over the past 5 auctions, although the number of offered share packages has been steadily dropping from auction to auction (starting with A6). As shown below, the net increase in the value of auctioned share packages was caused chiefly by the increasing ratio of share packages from indexed enterprises v. those from non-indexed enterprises. As with PPC auctions, the ratio between the number of share packages of indexed and non-indexed enterprises changed over time, albeit not so dramatically as in PPC auctions.

Chart 2.2.2. CC auction participation of indexed/non-indexed enterprises

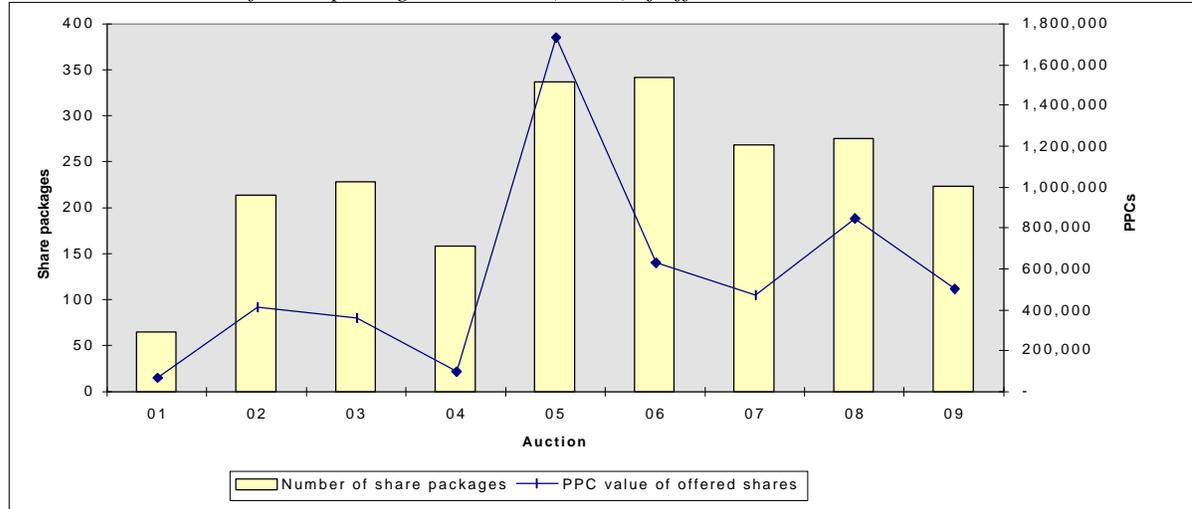


As the chart shows, beginning with CC auction 6, the majority of share packages represent indexed enterprises. If an indexation adjustment is applied to the absolute values of offered share packages, then the total offered value will look different, especially for the most recent auctions. The following chart is a representation of total values of share packages at CC auctions calculated in their PPC equivalent.

The sharp increase at Auction 5 was caused by one particularly large share package that accounted for roughly 64% of the total PPC value of share packages offered at that auction. That share package yielded >50% of CCs collected at Auction 5 and almost 17% of all CCs

collected during the first 7 CC auctions. So, after the indexation adjustment was applied the increase in absolute value of offered share packages after Auction 5 is less pronounced, albeit incontrovertible.

Chart 2.2.3. Number of share packages and value (PPCs) of offered shares at CC auctions



It is difficult to determine the auction demand trends based on the number of shares sold at CC auctions, because according to CC auction regulations all of the offered shares should be distributed among the auction bidders. Therefore, to enable reliable assessment of the auction demand it is necessary to consider the number of auction bids as well as the number of invested certificates.

Table A2.2.3 (attached) contains details on CC auction demand with a breakdown by auction, but the following table highlights the totals and averages for CC auctions.

Table 2.2.2. CC auction participation for 1996 by number of bids and invested CC4s

Indicator	Total	1996*		
		Auction average	Max	Min
Total number of bids	237,677	33,953.86	46,128 (A6)	19,177 (A1)
Bids from individual bidders	237,299	33,899.86	46,015 (A6)	19,177 (A1)
Bids from legal entities (LE)	378	54.00	165 (A7)	0 (A1,2,3)
Total submitted CCs	10,773,277	1,539,039.57	3,605,953 (A5)	661,998 (A2)
Total CCs submitted by individual bidders	7,243,990	1,034,855.71	1,726,259 (A5)	661,998 (A2)
Total CCs submitted by legal entities	3,529,287	504,183.86	1,879,694 (A5)	0 (A1,2,3)

*) excluding results of the 8th and 9th CC auctions

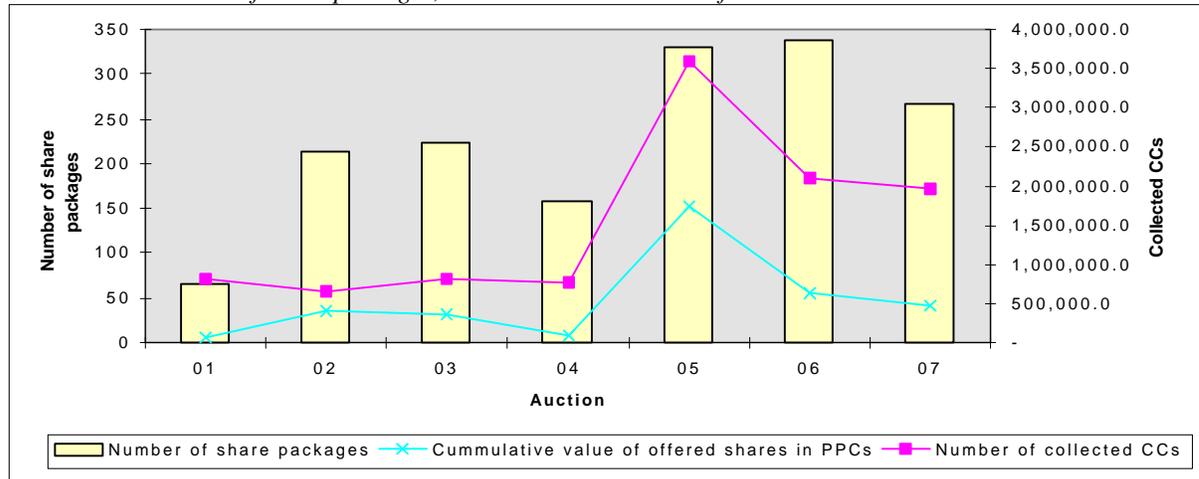
The above table shows that in CC auctions the percent of CCs invested by legal entities (32.88%) is lower than in the PPC auctions. While the trend has been changing lately (legal entities are slowly beginning to constitute a greater portion of all CCs invested), the legal entities representatives presumably have been investing these CCs as individual bidders; this accounts for part of the discrepancy/difference. The cumulative number of CCs invested by individual bidders exceeds the number of CCs invested by the legal entities by a factor of more than 2.

The chart below shows the correlation between the number of auctioned share packages, their cumulative value and the number of CCs collected at the corresponding auction. It

4 1 CC in this report is always equal to 10 UAH

appears that the number of collected CCs is more related to the value (and presumably quality) of the offered share packages than to the number of share packages outstanding at auction.

Chart 2.2.4. Number of share packages, their value and number of collected CCs at CC auctions



For the first 7 CC auctions, results for 17 share packages were not approved by the Auction Commission for various reasons, such as errors in the auction information note, unauthorized auction participation, and other.

3. Auctions analysis/issues

3.1 Proposed share packages

PPC Auctions

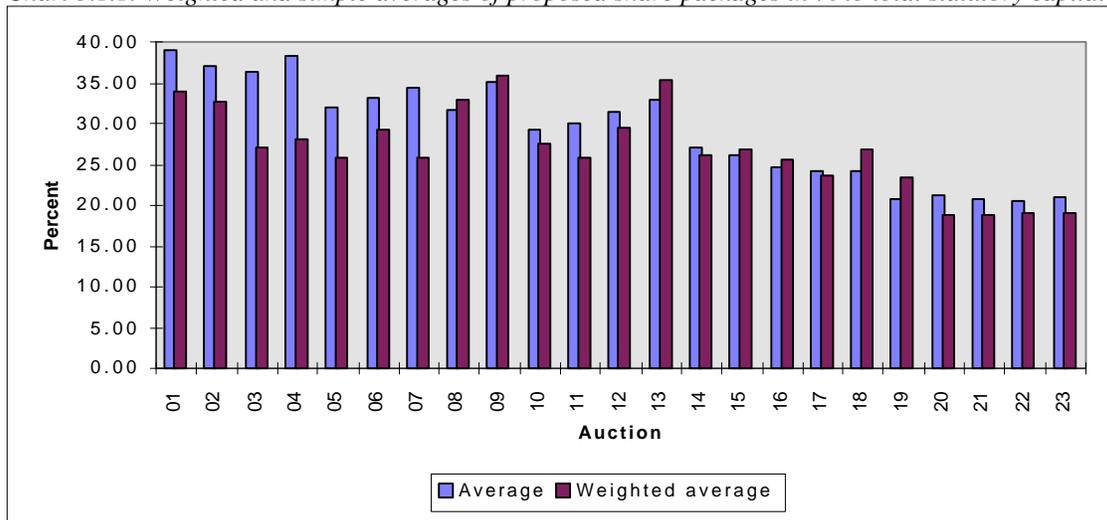
The share packages participating at PPC auctions are diverse in terms of their size relative to the total enterprise statutory fund and their absolute value. The table below shows some of the characteristics of the share packages proposed at PPC auctions during 1995-1996. One consistent trend does reveal that during 1996 all indicators have been going down steadily.

Table 3.1.1 Basic facts on the share packages offered on PPC auctions

Indicator	1996			1995		
	Average	Max	Min	Average	Max	Min
Size of proposed share package relatively to the statutory capital (%)	23.95	98.8	0.00003	33.57	100	0.00008
Absolute size of proposed share package (Hr)	219,668.20	20,877,140	29	84,306.62	6,096,677	42
Absolute size of proposed share package measured in PPC (PPC)	1,868.38	715,951.43	2.16	5,162.56	580,635.90	4

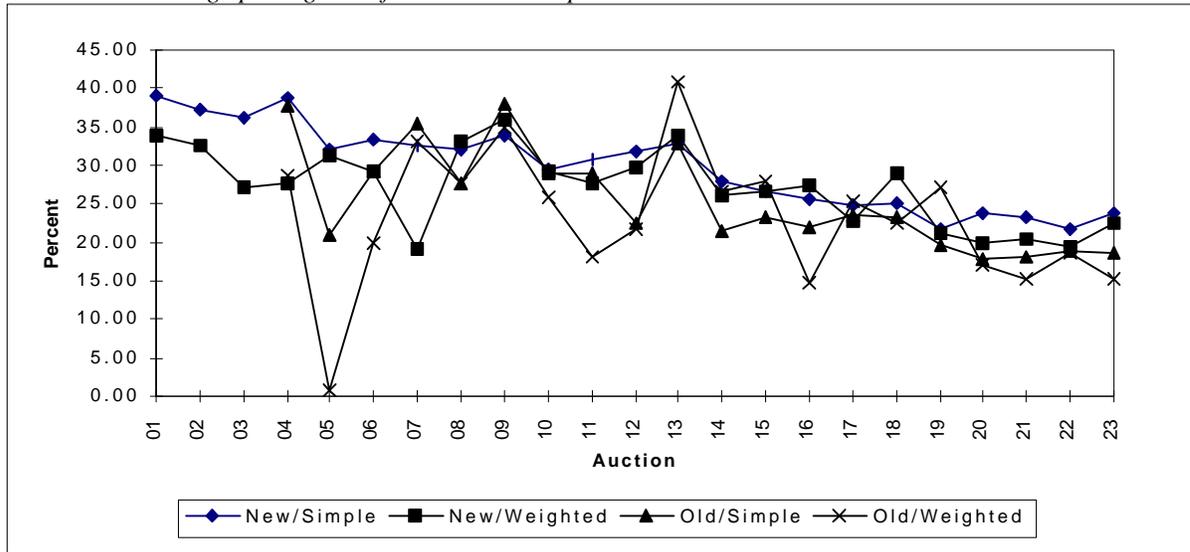
Table A3.1.1 (attached) presents the simple and weighted averages of share package sizes with a breakdown by PPC auction and the next chart is based on data from said table. It includes both simple and weighted averages of share package size, as both of these represent an accurate indicator. However, the weighted average takes into account the absolute size of a share package and the simple average does not. So, if the weighted average exceeds the simple average, then more large share packages (in terms of their absolute value) have been offered at the auction. The opposite holds true as well.

Chart 3.1.1. Weighted and simple averages of proposed share packages in % to total statutory capital



The chart shows that both the simple average and the weighted averages have been decreasing steadily. One of the underlying reasons for this trend may be the growing ratio of repeated enterprises, that is enterprises which have already proposed shares in previous auctions. However, Table A3.1.2 (attached), which presents the information from Table A3.1.1 with a breakdown by old/new enterprises, proves that this is not the case: the

average size of share packages decreases both for new and old enterprises and the difference in size of package although exists, is marginal (see the chart on the next page):
Chart 3.1.2. Average package size for new/old enterprises at PPC auctions



Note: the above chart was not intended to indicate the actual percentages (these can be obtained from the attached table), its purpose is to show that there is no considerable difference in size of share packages of old/new enterprises.

CC Auctions

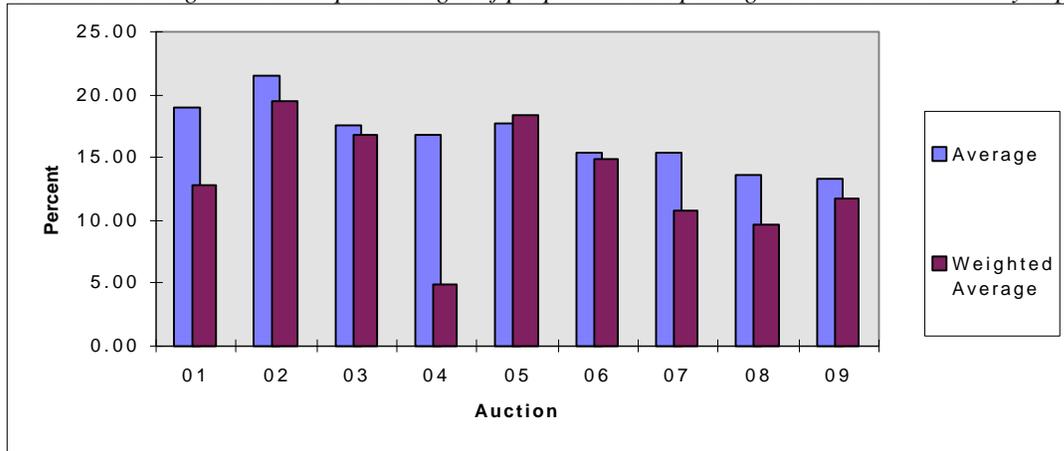
The share packages offered at CC auctions in general exhibit the same tendencies as the share packages offered at PPC auctions. However, their relative and absolute size tends to be smaller than the package size for PPC auctions. The table below contains the average and extreme values of share package size at CC auctions:

Table 3.1.2 Basic facts on the share packages offered on CC auctions

Indicator	Average	Max	Min
Size of proposed share package relatively to the statutory capital (%)	16.36	81.56	0.0001
Absolute size of proposed share package (UAH)	117040.98	11,686,947.75	51.75
Absolute size of proposed share package (PPC)	2,424.78	1,113,042.64	0.474

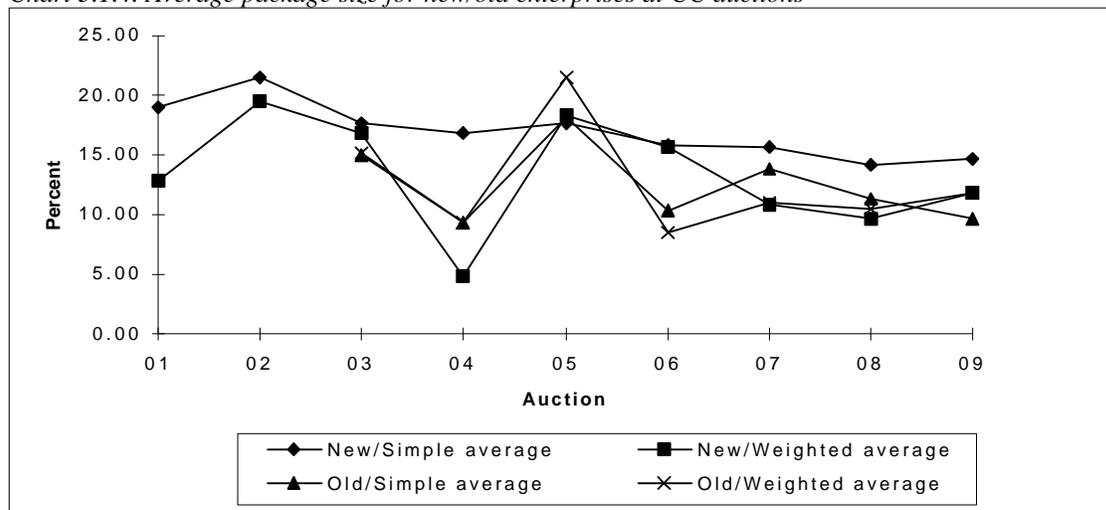
Table A3.1.3 (attached) contains a breakdown of the simple and weighted averages of proposed share packages at CC auctions. The chart below is based on said table:

Chart 3.1.3. Weighted and simple averages of proposed share packages in % to total statutory capital



There is a clear and steady decrease in the size of share packages just as with PPC auctions. For CC auctions the average share package size is well below the currently allowed maximum of 30%. Yet another chart shows that there is no significant difference between the package sizes for new and old enterprises:

Chart 3.1.4. Average package size for new/old enterprises at CC auctions

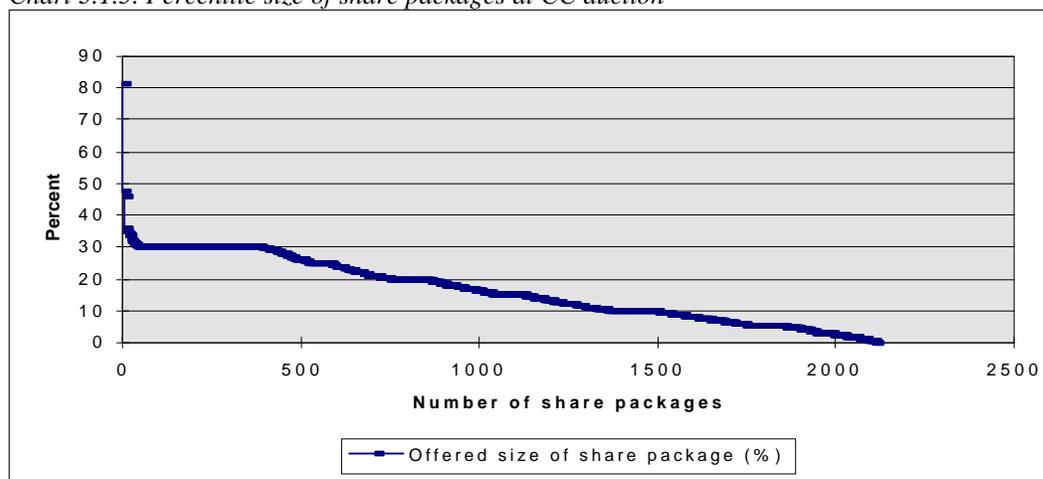


Note: the above chart was not intended to indicate the actual percentages (these can be obtained from the attached table), its purpose is to show that there is no considerable difference in size of share packages of old/new enterprises.

The data supporting the above chart is provided in the attached table A3.1.4.

The problem of new/old share packages is not as acute in CC auctions as it is in PPC auctions. The fact that CC auctions regulations provide for a complete sale of the offered shares regardless of the auction demand, ensures that the shares once offered for auction will indeed be sold and cannot be offered in subsequent auctions. Thus, all “old” enterprises offer additional packages of shares. Sometimes the necessity to split a large share package into several smaller is caused by the 30% share package restriction. The chart below shows that only about 450 share packages out of 2112 were equal to or larger than 30% of the corresponding statutory capital.

Chart 3.1.5. Percentile size of share packages at CC auction



In general, the number of enterprises which have offered to date more than 30% (in total) of their statutory fund is 233 (11.03% of all enterprises which participated in CC auctions). At the same time, 113 enterprises which participated in more than one CC auction, have the cumulative value of their shares offered at these auctions at or below 30% of their respective statutory funds.

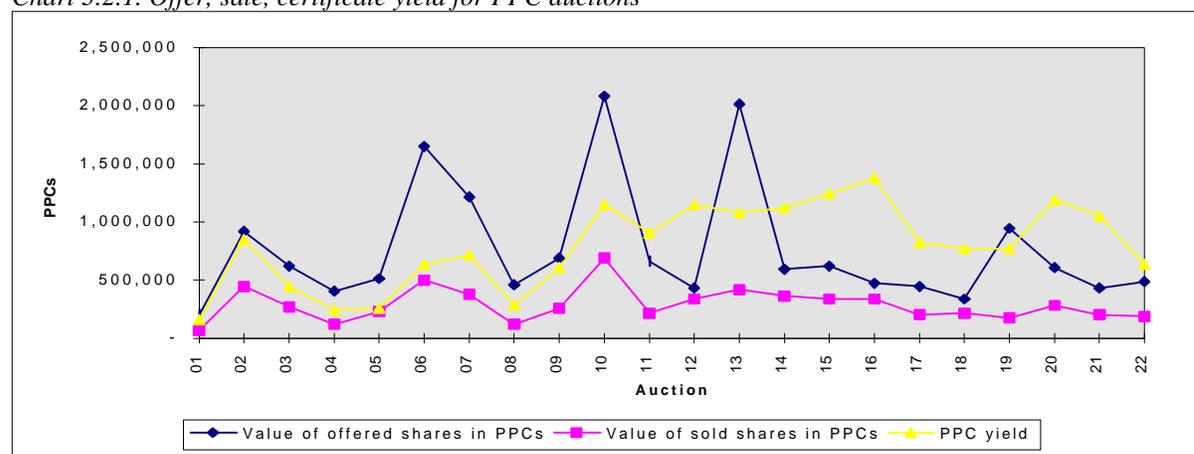
3.2 Auction demand/Certificate collection

PPC Auctions

At auctions during 1996 on average 77.37% of the offered share packages, or 17.87% of an enterprise statutory fund were sold (during 1995: 46.52% and 13.66% respectively). It can be inferred that the average percentage of offered packages sold has risen from 46.52% in 1995 to 77.37% in 1996 not because an increase in auction demand, but because a fall in the size of offered share package. The net percentage of sold capital has increased only marginally from 13.66% in 1995 to 17.87% in 1996. Therefore, the sharp decrease in the size of proposed share packages did not cause a decrease in the net volume of sold shares. On the contrary, during 1996 the net percent of sold statutory fund has registered an increase of over 4%. In general, if the shares of an enterprise sold at different PPC auctions are added than the average enterprise sell 25% of its statutory fund at PPC auctions.

An average of 355.96 bids were made for each share package (354.12 individuals and 1.84 from financial intermediaries). In 1995, the respective averages were 395.93 bids, 394.46, and 1.47. Thus, the public's activity in PPC auctions has decreased marginally, while financial intermediaries participation in auctions has become more active. Moreover, if in 1995 the average financial intermediary bid was 1.90 times greater than the amount of certificates needed to buy out the whole share package at nominal price, in 1996 this coefficient was 4.46. Financial intermediaries competition for shares has evidently also increased. All told, the financial intermediaries bid for 2835 share packages out of 5707 with approved results to date (44.4% of all offered share packages in 1995 and 52.2% in 1996).

Chart 3.2.1. Offer, sale, certificate yield for PPC auctions



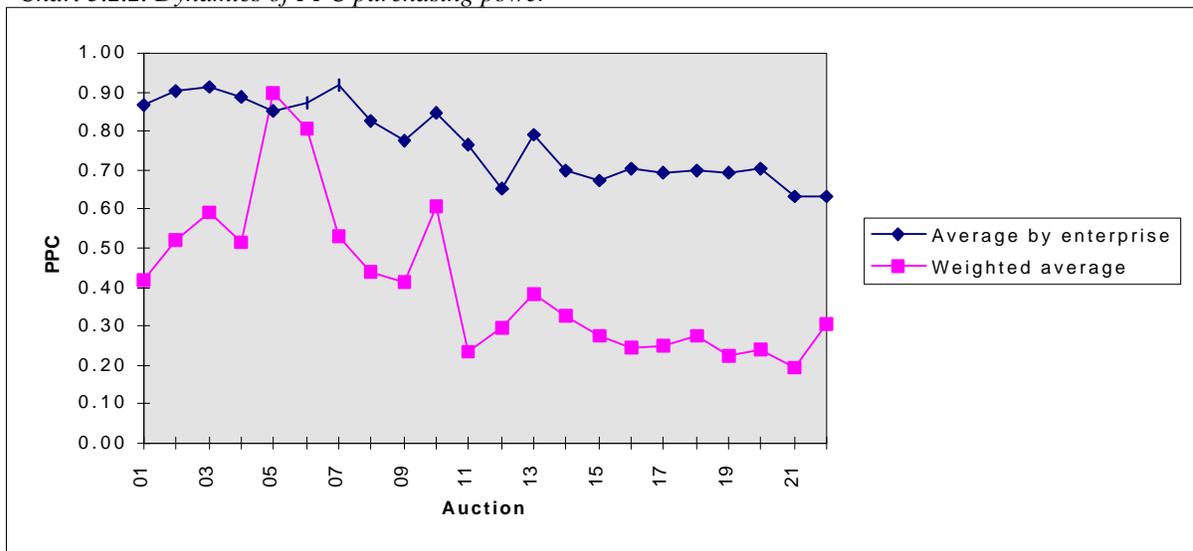
The number of PPCs collected per auction has stabilized in 1996 at approximately 1 mln. per auction in a band of 200,000-300,000. Financial intermediaries account for approximately 88% of all PPC investment. The chart on the previous page displays the

dependency existing between the value of the offered shares, the number of collected PPCs, and the value of sold shares.

The value of collected PPCs - 17,460,540 PPC equivalents - exceeds considerably the nominal value of all sold shares - 6,187,551.81 PPC equivalents (272%). Thus, in general, for PPC auctions, the value of the sold shares is 2.7 times below the value of collected PPCs.

The chart below displays the dynamics of the volume of property purchased per one PPC in nominal prices. Two methods have been used to assess this process: the upper line represents the simple average and does not factor in the size of the bid: for example, if a PPC invested in two enterprise bought in the auction 100 UAH worth of shares of one enterprise and 200 UAH in another auction then the average is $(100+200):2=150$ UAH/PPC. The lower line uses the size of the bid to determine the average: for example, if in the previous example the total number of PPC invested in the first company was 10 and for the second it was 5 then the average is $(10*100+5*200):(10+5) = 133.3$ UAH/PPC.

Chart 3.2.2. Dynamics of PPC purchasing power



There is a declining trend in terms of the amount of property purchased per PPC. At the most recent auctions, on average, shares were sold at 4-5 times their nominal price.

PPC Investment

During the first 22 PPC auctions, a total of 17,460,540 PPC won shares on PPC auctions. The PPCs were invested during the auctions based on different criteria which determine the general enterprise attractiveness for the investor. Although these criteria may vary for different investors (for example, the geographical location of an enterprise), there does appear to be a general consensus as to what constitutes an worthwhile enterprise from an investment perspective. This is why the PPC investment is highly unbalanced. PPC collection statistics reveal several facts which describe more succinctly how unbalanced PPC investment really is.

To wit:

- the Top 10 enterprises 5 (or 0.27% of total number of enterprises which participated in PPC auctions) yielded 21.45% of all collected PPC;
- the Top 100 enterprises (or 2.66%) accumulated 60.81% of all collected PPC;
- the Top 10% of enterprises (or 376) accumulated 80.96% of all collected PPC;
- the number of bottom companies which gathered 1% of all PPCs, is 1541, or 41.05% of all enterprises.

For these top enterprises, the relative percentile size of their share offerings is generally higher than the general average. Also, most of these enterprises have large statutory funds in absolute value, exceeding normal averages. For example, the average statutory fund of a top 100 enterprise is 13-14 times the overall average statutory capital value. In other words, the large, nationally-known enterprises account for most of collected PPCs.

The table below shows the PPC collection statistics by industry (only the 25 most “PPC-attractive” industries):

Table 3.2.1 Top 25 industries (in terms of PPC investment)

#	LINE OF PRODUCTS	# of JSC	Invested PPCs
1	PETROLEUM PROCESSING INDUSTRY	6	1,122,730
2	METALLURGY	3	533,045
3	SUPPLIES	256	479,018
4	STRIP MINING FOR BLACK METALS	1	435,139
5	COKE CHEMICAL INDUSTRY	1	394,693
6	GAS SUPPLY	50	348,280
7	GOVERNMENT TRADE ENTERPRISES WITH THE EXCEPTION OF PHARMACEUTICAL ESTABLISHMENTS	57	296,315
8	ARTIFICIAL DIAMONDS, ABRASIVES AND RELATED TOOLS MANUFACTURING	5	272,053
9	FERROUS METALS ORES EXTRACTION	1	263,002
10	CHEMICAL INDUSTRY	4	254,314
11	CHEMICAL FIBRES AND YARN MANUFACTURING	1	244,516
12	FERROUS METAL MANUFACTURING	5	243,226
13	WELDING INDUSTRY	1	238,129
14	WOOD PULP, PAPER, CARDBOARD MANUFACTURING	6	226,477
15	SUGAR MANUFACTURING	35	186,267
16	PIPELINE PRODUCTION	5	184,011
17	CEMENT PRODUCTION	5	183,191
18	FOREIGN TRADE OF NON-GOVERNMENTAL ORGANIZATIONS	2	177,832
19	BUTTER, CHEESE, DAIRIES MANUFACTURING (EXCEPT CANNED DAIRIES)	93	171,475
20	HOTELS	7	161,925
21	PRODUCTION OF ELECTRONIC MACHINES, EQUIPMENT, AND PARTS OF PRODUCTIVE SIGNIFICANCE	47	156,928
22	ECONOMIC MANAGEMENT OF CONSTRUCTION	53	154,968
23	AUTOMOBILE INDUSTRY	477	154,271
24	INDEPENDENT DESIGN AND PROJECT ORGANIZATIONS	37	144,101
25	SCIENTIFIC ESTABLISHMENTS WITH A BRANCH PROFILE	47	142,035

Note 1: In the table above the used numbers represent the number of invested certificates, not winning certificates.

Note 2: For a part of enterprises that participated in PPC auctions the information about their industry code was missing. Therefore the numbers for some industries may be less than the number of enterprises actually pertaining to this industry. It is assumed though that these enterprises are spread uniformly among different industries and therefore the order of industries would not be affected.

5 The enterprises have been sorted in descending order according to the number of PPCs yielded during PPC auctions

Some industry branches, represented by a few or even only one enterprise, manage to accumulate considerable numbers of PPCs. For example, the 6 *petrol processing* enterprises accumulated more than twice the PPCs that 285 enterprises in *supplies* did. The ranking in the above table would be altered the industries were listed by the number of PPC collected per enterprise. The most accurate industry ranking (“popularity”) can be obtained, though, by calculating the number of PPCs invested related to the size of offered share package. In other words, the ratio between auction supply and demand should determine the industry rating. The table below contains the top 25 industry rating according to auction demand.

Table 3.2.2. Industry rating by the auction demand

¹	LINE OF PRODUCTS	# of JSCs	Total PPCs	Offered shares in PPCs	Auction demand coefficient
1	DEVELOPMENT AND INSTALLATION OF SOFTWARE	1	26,195	316.48	82.77
2	CHEMICAL-PHARMACEUTICAL INDUSTRY	4	39,899	876.00	45.55
3	ASPHALT-CONCRETE MANUFACTURING	5	35,684	936.26	38.11
4	FOODSTUFF (OTHER THAN FISH, MEAT AND DAIRIES) MANUFACTURING	5	79,822	2,780.11	28.71
5	METALLURGY	3	379,985	13,883.95	27.37
6	CONDIMENTS PRODUCTION	2	33,211	1,425.00	23.31
7	STRIP MINING FOR BLACK METALS	1	345,622	17,281.12	20.00
8	PRODUCTION OF MEDICAL EQUIPMENT FROM GLASS, PORCELAIN, AND PLASTIC	2	11,289	670.46	16.84
9	FERROUS METAL ORES EXTRACTION	1	208,502	13,012.80	16.02
10	BREWING	20	59,452	3,773.29	15.76
11	PUBLISHING AND PRINTING	1	14,077	939.00	14.99
12	COAL INDUSTRY	1	15,198	1,079.08	14.08
13	INTERMEDIARY SERVICES FOR THE PURCHASE-SALE OF CONSUMER GOODS	1	7,025	503.00	13.97
14	FOREIGN TRADE OF NON-GOVERNMENTAL ORGANIZATIONS	2	168,832	12,224.86	13.81
15	ARTIFICIAL DIAMONDS, ABRASIVES AND RELATED TOOLS MANUFACTURING	5	217,191	16,201.52	13.41
16	FIBRE PRE-PROCESSING	2	790	59.71	13.23
17	FISH INDUSTRY	5	66,955	5,318.20	12.59
18	ELECTRIC POWER NETWORKS	3	10,705	897.71	11.92
19	SALE	6	34,022	2,915.30	11.67
20	BAKERIES	6	6,644	580.42	11.45
21	GOVERNMENT TRADE ENTERPRISES WITH THE EXCEPTION OF PHARMACEUTICAL ESTABLISHMENTS	57	278,884	25,737.63	10.84
22	PRODUCTION OF MISCELLANEOUS BASIC CHEMICAL PRODUCTS	3	36,993	3,567.77	10.37
23	CONFECTIONARY INDUSTRY	9	9,500	1,008.56	9.42
24	STORAGE ORGANIZATIONS	19	16,448	1,846.04	8.91
25	TOYS MANUFACTURING (RUBBER TOYS EXCLUDED)	3	9,663	1,098.05	8.80

Note: For a part of enterprises that participated in PPC auctions the information about their industry code was missing. Therefore the numbers for some industries may be less than the number of enterprises actually pertaining to this industry. It is assumed though that these enterprises are spread uniformly among different industries and therefore the order of industries would not be affected.

PPC Overhang

The 17,460,540 winning PPCs from the first 22 PPC auctions represent roughly one-third of all emitted PPCs/privatization accounts. When correlated with the total value of property offered on sold during these auctions, valuable statistics could be generated which could significantly aid the process of auction planning for 1997. However, besides PPC auctions, PPCs may be utilized in a number of other ways, including preferential sales (large-scale) and small-scale auctions. Data on certificate “absorption” by these privatization methods should be researched in order to produce more reliable data. At the time of writing this report, such data was yet not available.

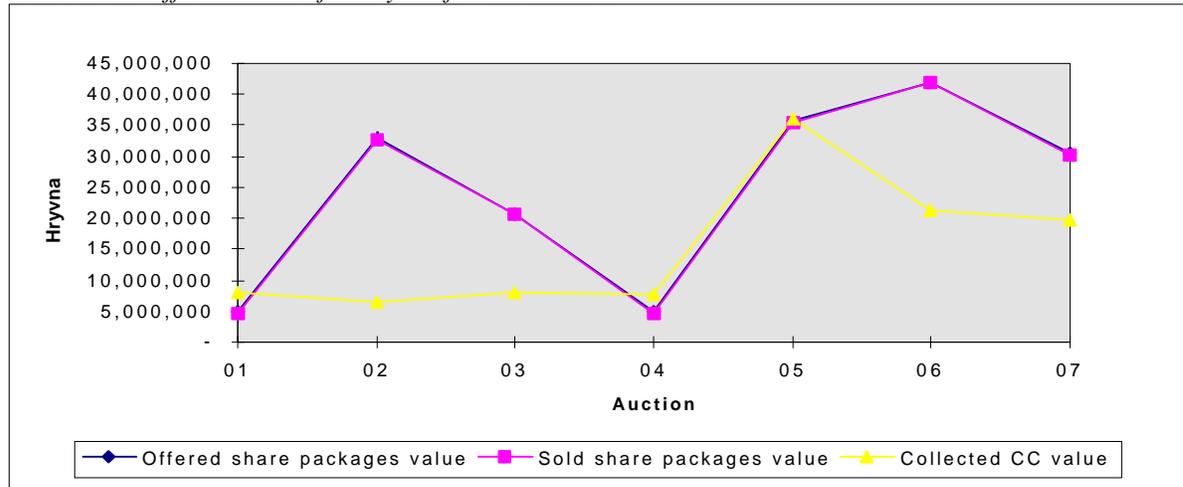
CC Auctions

During CC auctions the participating enterprises sell an average 98.93% of the proposed share packages, or 17.02% of the enterprise statutory fund.

A total of 234,955 bids were made during the first 7 CC auctions --on average 33,565 bidders per auction, or 147.12 bids per share package. During the first 3 CC auctions no bids from legal entities were submitted, due to a lack of relevant bid submission procedures. However, during auctions 4-7 the legal entities accounted for 41.18% of all invested CCs. During these auctions the legal entities bid for only 233 share packages out of the 1,095 proposed (21.3%).

The chart below displays the correlation between the share offer and certificate yield. The number of collected certificates per auction increased abruptly on auction 5, but decreased slightly afterwards.

Chart 3.2.3. Offer/Sale/Certificate yield for CC auctions



CC Investment

During the first 7 CC auctions, 10,731,419 compensation certificates were invested. This amounts to approximately 24.15% of the CCs distributed to date and to only 3.21% of all emitted CCs. There is a significant difference (approx. 10 times) between the percent of all PPC and CC invested to date through certificate auctions.

As with PPCs, CC investment is very unbalanced. Following are some of the characteristics of CC investment:

- the top (1) share package collected 1,810,889 CCs or 16.87% of all invested CCs during the first 7 auctions; the absolute value of the offered share package is 6.82% of the value of all share packages offered during CC Auctions 1-7; the value of this share package measured in PPCs (i.e., taking into account the indexation effects) amounts to approximately 64% of the cumulative value of all offered share packages at the respective CC auction;
- the top 10 enterprises (0.66% of all auctioned enterprises) yielded 33.88% of all CCs collected to date;
- the top 100 enterprises (6.59% of all auctioned enterprises) yielded 64.05% of all CCs collected to date;
- the top 10% of participating enterprises (or 152) yielded 71.31% of all CCs collected to date;
- the number of bottom enterprises to collect 1% of all gathered CCs is 458 (or 30.19% of all enterprises).

Again, the analysis of the share packages of enterprises that collected most of the CCs are large enterprises and logically the offered share packages have a large absolute value.

The table below lists (in descending order) the top 25 branches of industry which accounted for most of the collected CCs:

Table 3.2.3. Top 25 industries (in terms of CC investment)

#	LINE OF PRODUCTS	# of JSC	Invested CCs
1	COKE CHEMICAL INDUSTRY	1	1,810,889
2	HOTELS	3	540,154
3	CHEMICAL & PETROCHEMICALS (WITHOUT PHARMACEUTICS)	2	267,258
4	SUPPLIES	62	248,489
5	TRACTOR MACHINE BUILDING	8	247,849
6	PRODUCTION OF STEEL CONSTRUCTION STRUCTURES	12	228,460
7	FOREIGN TRADE OF NON-GOVERNMENTAL ORGANIZATIONS	2	224,630
8	INDUSTRY	8	198,818
9	AUTOMOBILE INDUSTRY	142	161,395
10	PRODUCTION OF METALCUTTING MACHINES	12	156,724
11	CABLE INDUSTRY	3	145,075
12	ECONOMIC MANAGEMENT OF CONSTRUCTION	23	135,127
13	INDUSTRY OF THE PRODUCTION IRON/CONCRETE AND CONCRETE CONSTRUCTIONS AND PARTS (WITH THE EXCEPTION OF WALL MATERIALS)	55	128,890
14	DAIRIES MANUFACTURING (WITHOUT CANNED DAIRIES)	23	126,564
15	CARDBOARD AND PAPER PACKING MATERIALS MANUFACTURING	3	120,864
16	PRODUCTION OF ELECTRONIC MACHINES, EQUIPMENT, AND PARTS OF PRODUCTIVE SIGNIFICANCE	15	119,777
17	ARTIFICIAL DIAMONDS, ABRASIVES AND RELATED TOOLS MANUFACTURING	3	111,829
18	UNCLASSIFIED	59	109,294
19	HYDROTECHNICAL WORKS	2	105,680
20	MACHINE BUILDING & METAL PROCESSING (EXCEPT MEDICAL EQUIPMENT)	22	105,374
21	FIREPROOF MATERIALS MANUFACTURING	3	104,985
22	PRODUCTION OF BUILDING BRICKS AND CERAMIC TILES	42	101,293
23	MEAT INDUSTRY (WITHOUT GLUE AND GELATINE)	13	93,185
24	METAL & TIMBER PROCESSING TOOLS	3	89,039

	MANUFACTURING		
25	SCIENTIFIC ESTABLISHMENTS WITH A BRANCH PROFILE	15	86,248

Note: For a part of enterprises that participated in PPC auctions the information about their industry code was missing. Therefore the numbers for some industries may be less than the number of enterprises actually pertaining to this industry. It is assumed though that these enterprises are spread uniformly among different industries and therefore the order of industries would not be affected.

The top industries are represented only by a few or even one enterprise. The top 25 industries for PPC and CC auctions do overlap: 10 industries can be found on both lists. Enterprises of 6 industries on the top PPC collection list have not (yet?) offered their shares at CC auctions.

The information from the table above may be used to increase the efficiency of PPC auctions by selecting for PPC auction participation enterprises pertaining to those industries that have proven to be very “attractive” to the investors.

CC Overhang

As with PPCs, it would be useful to examine CC investment in other forms of sales; however, such data was not yet available at the time of writing this report.

3.3 PPC versus CC auctions

Auction methodology

PPC auctions and CC auctions are two types of auction which have very much in common, however they have many differences. This section will give a description of the most significant differences between PPC and CC auctions.

PPC and CC auctions are two types of nation wide certificate auctions that are employed to provide a mechanism of property transfer within the bounds of Ukraine Mass Privatization. These two types of auctions, having a lot of common attributes, differ in some of fundamental concepts, underlying the auction methodology. The most important difference is determined by the auction regulations. At PPC auctions shares in auctioned enterprises cannot be sold at prices below nominal. At CC auctions the shares can be sold at prices over and below the nominal price, the final auction rate being determined exclusively by the auction supply and demand for shares. In this sense the CC auctions are more friendly to investors, allowing for a real auction price to be established. The fact that the CCs are freely tradable is another factor that makes the CC auctions more attractive to the potential investors. The public has the option to sell their CCs and make an immediate profit, or accumulate some more CCs and get a larger share package in selected enterprises.

Therefore, as a result of PPC auctions there will be created a relatively large number of shareholders, each owning a relatively small number of shares. The CC auctions, on the contrary, will result in a smaller number of shareholders, each, however, with a relatively larger share package. The latter, presumably, is more favourable for a secondary securities market development and for an effective management of privatized JSC (it results in a higher concentration of capital and it’s easier, for example, to have a shareholder’s meeting).

Offered share package size

Because the majority of enterprises that participated in CC auctions also participated in PPC auctions and because in many cases the shares offered at CC auctions are composed of the

shares left unsold after PPC auctions, the size of the share package offered at CC auctions is smaller than those offered for PPC auctions. The average package size offered by an enterprise at PPC auctions is 26.85% of the statutory fund, while at CC auctions this indicator equals 17.24%. Out of 1810 enterprises that have participated in both PPC and CC auctions, 1524 have offered larger share packages at the PPC auctions.

Auction demand

It would be an imprecise exercise to compare the difference in auction demand for two different share packages, to say nothing about two different types of auctions. Generally speaking, if shares of the same enterprise are auctioned at different auctions, then the auction demand should be the same. But, in fact, the level of auction demand is different for most enterprises participating in more than one auction. Therefore, the level of auction demand is determined by factors specific to particular auctions (e.g., approaching end dates of certificate distribution), in addition to the factors specific to the enterprise. These auction-specific factors may include the relative size of the offered package, the order in which the auctions are conducted, and other.

That is why below the auction demand will be considered in terms of the value of shares, purchased for 1 certificate at each type of auction. For accuracy, the value of shares purchased in indexed enterprises will be decreased accordingly.

For reasons described above, it is more advantageous to use CCs, rather than PPCs, for purchasing shares in enterprises that are not likely to have a high auction demand. However the following table shows that the PPC purchasing power is marginally greater than the CC purchasing power for all enterprise categories (over-subscribed and under-subscribed):

Table 3.3.1 Value of shares purchased per certificate at PPC and CC auctions

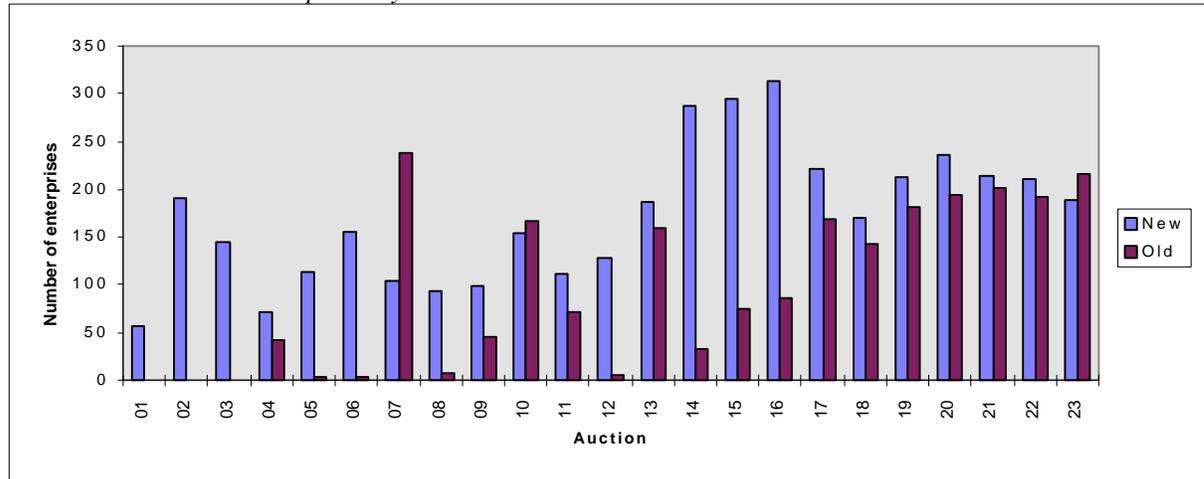
Indicator	PPC auctions		CC auctions	
	# of invested certificates	Value purchased per certificate	# of invested certificates	Value purchased per certificate
Total, including	17,460,540	3.84	10,731,419	3.62
over-subscribed share packages	15,625,682	3.06	8,429,400	2.65
under-subscribed share packages	1,834,858	10.5	2,302,019	7.15

It is interesting to compare the numbers in the table above with the exchange prices for CCs and PPCs. The price for a PPC as of mid-December was approximately \$5.2 and the price for a CC was approximately \$1.1. The discrepancy between the market prices for PPCs and CCs and their purchasing power at certificate auctions can be explained by the fact that the PPC auctions offer more share packages in “attractive” enterprises than CC auctions. Thus a PPC owner has more chances of becoming a shareholder in an “attractive” enterprise, albeit the absolute size of his/her stake will be comparable with the size of a share package purchased in CC auctions.

3.4 Multiple auction participation

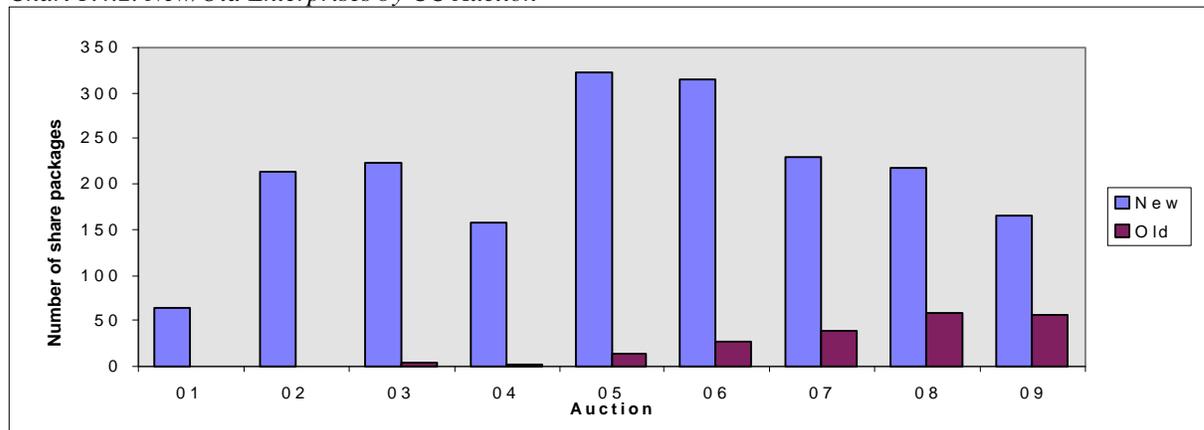
Multiple auction participation⁶ is a practice that became more common towards the end of 1996, because during the first auctions the majority of enterprises were new to the auction process. The chart below shows the breakdown by PPC auction of new/old companies and confirms that the ratio of old companies is increasing: at the last PPC auction, it even exceeded 50%. At the same time, the number of new enterprises is declining both for PPC and CC auctions.

Chart 3.4.1. New/Old Enterprises by PPC Auction



The following chart displays the same information for CC auctions.

Chart 3.4.2. New/Old Enterprises by CC Auction



Several facts can be considered as direct or indirect causes for multiple auction participation:

- Some enterprises enjoyed only a very low demand for their offered shares during the PPC auctions and as a result had many shares left unsold; this created a surplus supply of shares for future auctions; this was particularly true for the early PPC auctions when the general level of demand for shares was low;
- The monthly auction schedules (or the so-called ‘plan-graphics’) require the RPFs to constantly supply a number of share packages for the upcoming auctions. These plan-

⁶ A company is said to have participated in multiple auctions if it participated in more than one auction of the same type (PPC or CC)

graphics do not specify whether the share packages must be for enterprises which never participated in auctions. This practice had the peculiar effect of creating an incentive for RPF management to artificially split large share packages into smaller ones and offer these at multiple auctions instead of satisfying the quota with packages of new enterprises. They were thus able to alleviate the pressure of preparing large numbers of enterprises;

- The 30% maximum limit of the statutory capital for CC share packages is yet another cause for multiple auction participation in CC auctions: a large share package will be split into several smaller ones, each sized under 30% of the enterprise charter capital.

The multiple auction participation decreases the work efficiency of the SPF, RPFs and UCCA, because instead of RPF preparing an enterprise information package once, SPF processing it once and UCCA selling it once these processes are performed multiple times for smaller share packages. The resources used thereby can be effectively used for preparing new enterprises for the certificate auctions.

Multiple auction participation may, among other things, negatively impact the equity of the auction process by causing different auction prices for the share of the same enterprise. Cases have been observed in which the number of shares purchased at one CC auction was 40 times the same number at a previous auction (for the same enterprise). Of course, it is unlikely that this could have been the case with market prices of those shares during the period between the corresponding auctions. While such a rise in prices is especially characteristic for CC auctions, where shares can be sold at prices over and under the nominal value, there are similar cases of enormous differences in price at PPC auctions (up to 20 times). Such cases go directly against the spirit of the mass privatization process and disrupt the public faith in the equity of the certificate auctions.

Besides having such a negative impact on the public faith in the equity of the mass privatization program, this consequence may give a strong incentive to financial intermediaries not to settle for the shares they purchased at “more expensive” auctions. Furthermore, because of the artificial share package split, the average size of a share package is diminished. That is why the “strategic investors” who are interested in purchasing large share packages, may abstain from bidding on relatively small share packages, even when an “attractive” enterprise is offered.

Additionally, allowing RPFs to split the share packages “artificially” in order to achieve the requisite number of share packages detracts from the RPF efforts to prepare new enterprises. Reprocessing the share packages of previously auctioned enterprises absorbs critical resources and negatively impacts RPF efficacy.

One of the presumed advantages of the multiple auction participation is the increased certificate yield. Indeed, statistics show that in half the cases of repeated PPC auction participation enterprises gather more certificates than during the previous auctions and in the rest of the cases it will yield fewer certificates. However, with regulations prohibiting sale of shares at PPC auctions below their nominal value, putting large share packages on PPC auctions does not have any perceptible negative impacts on this trend.

3.5 Parallel auction participation

With the commencement of CC auctions, another auction participation practice has emerged: parallel auction participation. That occurs when an enterprise offers shares in two simultaneously conducted auctions --one for PPC and the other for CC--, or when a share package is offered for one auction, before the auction results are approved for a different share package of the same enterprise. This exercise is an ill-advised attempt to accelerate the privatization process, as the results of the earlier auction are not taken into account when preparing the share package for the later auction. The results can be just a share leftover, which could have been added to the share package offered at the later auction. In some cases, however, the effects are more significant: if the auction calculation for the first auction produced a stock split then this split will not be considered during the second auction calculation. Such cases are relatively rare (40-60). There are three ways to address this problem:

- prohibit auction participation for enterprises, which still have outstanding auction results;
- keep track of such cases and, if necessary, apply the same stock split coefficient during the second auction calculation;
- allow this practice and reregister the share emission after all shares have been sold at auctions.

From the practical point of view (and considering its simplicity) the first option is more advisable.

3.6 Stock splits

A stock split causes a decrease in the share value and a proportional increase in the total number of shares. Although a stock split does not have any net effect on the investors holdings, it requires the enterprise to reregister its share emission, which can be both time-consuming and costly. This is why, whenever possible, stock splits during auctions should be prevented.

During PPC and CC auctions, stock splits are applied in order to achieve a higher share distribution rate between the auction bidders. At PPC auctions the stock split is applied in most cases when share packages are oversubscribed and when it would be difficult to obtain a high percent of share distribution without a stock split. At PPC auctions the cases of stock splits are relatively rare (only 215 during 22 auction; on average 10 cases per auction). The absolute size of a share package for the enterprises which had applied a stock split is on average one third of an average package size for an enterprise that had not been applied stock split. Therefore, it follows that in order to avoid stock splits it would be advisable to avoid putting for auctions share packages with a limited PPC equivalent size.

At CC auctions, due to CC auctions regulations (mandatory sale of 95% of the offered shares), the frequency of stock splits is much higher. Of the 1597 share packages with approved results, 354 have had stock splits applied, representing an average of approximately 50 per auction.

The stock split problem is particularly acute in cases when the relative size of the share package sold at auction is small (<5%). Table 3.6.1 shows that the smaller the share

package, the greater the probability that the shares will be split. This probability is particularly high at CC auctions, due to the CC auctions regulations and the overall low share package size.

Table 3.6.1. Frequency of stock splits for different share packages

Size of package (%)	PPC Auctions			CC Auctions		
	Number of enterprises	Stock splits	%	Number of enterprises	Stock splits	%
0-1%	44	4	9.09%	24	11	45.83%
2-5%	353	24	6.80%	156	47	30.13%
6-10%	614	24	3.91%	275	53	19.27%
10-20%	1406	53	3.77%	473	100	21.14%
20-30%	1123	35	3.12%	448	100	22.32%
30-50%	1444	56	3.88%	220	43	19.55%
over 50%	723	19	2.63%	1	0	0.00%
TOTAL	5707	215		1597	354	

3.7 Unsold share packages/leftovers

At certificate auctions a whole number of shares is distributed among a whole number of bidders. In most cases, it is impossible to distribute all of the shares, so that each bidder gets an equal amount of shares per certificate. This is why in most cases there exists a number of shares which have not been sold during auction: the share leftovers. They usually constitute between 1-2% of the offered share package.

Table 3.7.1 below shows the number of enterprises that had unsold share packages and share leftovers with a breakdown by PPC auction.

Table 3.7.1. Number of auction unsold shares

Auction Number	Percentage unsold					Total enterprises with approved results
	<=1%	2-5%	6-20%	21-50%	over 50%	
01	7	3	3	2	40	55
02	14	17	11	10	135	187
03	7	18	8	10	100	143
04	10	14	12	10	64	110
05	13	22	7	8	66	116
06	21	32	13	9	82	157
07	43	40	23	24	209	339
08	18	16	8	10	49	102
09	45	18	13	9	54	139
10	71	47	23	24	153	318
11	53	24	14	12	77	179
12	59	26	13	11	26	135
13	120	47	25	16	132	340
14	173	36	21	21	62	313
15	189	36	27	19	94	365
16	217	38	28	30	82	395
17	210	47	17	22	88	384
18	165	33	18	15	77	308
19	229	31	26	24	79	389

20	246	31	13	33	102	425
21	257	29	19	22	81	408
22	260	23	15	21	81	400

The number of enterprises selling all offered shares in PPC auctions is increasing. However, this increase may be partly related to the decrease in the average size of the offered share package, rather than the increased auction demand or quality of offered share packages.

At CC auctions there can only be share leftovers. The average size of these CC leftovers is below 1% of the offered share package.

ACCELERATION OF THE PRIVATIZATION PROGRAM IN 1997

Slowdown and Acceleration in 1997

Following the success of 1996, it was recognized in early 1997 - having passed the halfway point in privatizing 8000 medium/large enterprises (the principal target agreed between the GOU and donors) - that the "pipeline" of medium and large enterprises beginning share sales each month was rapidly declining and that the GOU's privatization targets would not be met. The passage by the Parliament of a new Law on Compensation appeared to promise citizens cash compensation for inflationary losses and essentially halted citizens' collection of Compensation Certificates. New enterprise share allocation plans being approved by the SPF and the Cabinet (in the case of large, "Group D" enterprises) provided for smaller share packages to be offered for certificates, with larger packages to be offered in often non-transparent tenders and large packages to remain in the hands of the state.

In sum, as Ukraine's largest and most attractive enterprises completed preparation to begin share sales through mass privatization, the GOU appeared to be wavering in its commitment to rapid privatization via certificate auctions to employees and the public. The trend appeared to be, instead, toward sales of large share packages in the "best" and largest of Ukraine's industrial enterprises to "insiders" with the state retaining very large share holdings in nearly all such enterprises. This trend was exacerbated by a number of other political developments which served to greatly "politicize" the privatization program and slow it down and to intensify the rivalry between the GOU and the Parliament. This included the Parliament's adoption of a new Law on Privatization which, among other things, moved oversight of the SPF from the government to the Parliament; the Parliament's rejection of the President's proposed candidate for SPF Chairman; the Parliament's halting of the sale of strategic enterprises via investment tenders.

As a result of this trend, it was agreed in March 1997 that another joint donor letter be sent to the leadership of the government expressing the donors' concerns, indicating that new credits and technical assistance were at risk, and listing ten recommended action steps which the government should take to revive the mass privatization program. One month later, on April 7, 1997, a donor letter signed by the US Ambassador and senior representatives of the World Bank, the IMF and the European Union was sent to the Prime Minister. The letter was intended to galvanize the GOU into action prior to President Kuchma's visit to the US for meetings with President Clinton and US government officials, the Managing Director of the IMF and the President of the World Bank in May 1997.

The letter urged the SPF and the GOU to substantially increase the number of share packages of new enterprises offered each month in Privatization Property Certificate auctions and to substantially increase the number of share packages of enterprises which could reach a minimum of 70% shares sold in monthly Compensation Certificate auctions. Following the slower pace of mass privatization in the first half of 1997 (versus 1996) as a result of the political turmoil surrounding the privatization program, the donor institutions strongly encouraged the SPF and the GOU to develop, with donor/consultant assistance, specific plans to reach the GOU's commitment to privatize 8000 medium/large enterprises by the end of 1997.

During the month of June 1997, consultants halted all longer-term tasks and projects not directly related to the preparation of enterprise share packages for offering in the next PPC and CC auctions. All available resources were redeployed to the regions to assist the regional offices of the SPF in the preparation of share packages for auctioning. At the same time, intensified consulting assistance was provided to the SPF headquarters' management to consult on policy, procedures and data

analysis tasks necessary to process and to auction a significantly higher number of enterprises and to ensure accelerated auctions for the remainder of the year.

At the same time, the SPF and some Cabinet officials, responding to encouragement from the donors and their consultants, undertook a number of positive initiatives which accelerated share sales beginning in mid-1997:

- For the July 1997 Compensation Certificate auction, the SPF dramatically increased the number of enterprises, the number which would reach >70% sold and the size of the share packages offered. The value of shares auctioned was the largest ever offered in a CC auction, 350% more than the average value of share packages offered in the first six auctions of 1997.
- PPC and CC distribution were extended.
- The President signed the 1997 Privatization Program as approved by Parliament and which differed little from the President's proposal. Most importantly, the Program required that aggressive quotas be met whereby all medium and large enterprises were required to sell from 25% to 100% of their shares for certificates in preferential sales and public auctions *before* they could begin cash sales.
- In response to donor requests, the SPF began preparing a list of a (minimum) of 2400 medium/large enterprises to be privatized (70% of shares sold) via certificate auctions and/or preferential sales (for Agro-Industrial Enterprises) during the August - December 1997 period.

Donor encouragement and financing conditionalities produced a dramatic improvement in privatization results during the second half of 1997. This turnaround clearly indicated that the GOU - with political will and high level leadership support - could (and can) indeed accelerate the program. For example, versus Compensation Certificate auctions during the first half of 1997: the value of share packages offered in CC auctions during the second half of 1997 increased by more than 200%; the number of new enterprises offered increased by more than 60%; and the number of share packages offered increased by nearly 100%. All of this resulted in a dramatic increase in the number of medium/large enterprises reaching 70%+ sold: from an average of 125 enterprises per month during the first half of 1997 to an average of 275 enterprises per month (and as high as 350 per month) during the second half of 1997.

Certificate Auction Results: First Half of 1998

Since late 1997, the State Property Fund has been under orders from the Prime Minister and other officials in the Cabinet of Ministers to offer as many share packages as possible for cash sales (via stock exchanges and the OTC market, “mass” cash auctions, regional “dutch” auctions, commercial tenders) - in order to meet the objective of the 1998 Privatization Program to generate more than UAH 1 billion in privatization revenues. As a result, the SPF has gradually reduced both the quantity and quality of enterprises offering shares - and the size of share packages - in Privatization Certificate (PPC) and Compensation Certificate (CC) Auctions during the first half of 1998. This has led to a steady decline in the number of medium/large enterprises being privatized (reaching more than 70% sold) each month.

Under such pressure, the SPF’s strategy is to offer hundreds of share packages each month for cash - while telling the Government that the responsibility of the SPF is only to offer shares for cash, i.e. the SPF cannot be responsible for the success or failure of cash sales. Particularly because the Prime Minister/Cabinet of Ministers do not want the SPF to offer shares “too cheaply” (i.e. below nominal value).

Thus the SPF is in the unenviable position of having to generate cash while not having the flexibility to do so by offering shares at market prices instead of artificially high prices based on nominal value. The pressure continues with the Prime Minister, as recently as late June 1998, having advised the SPF that the Regional SPF branches must double their cash sales quotas.

Offerings in PPC and CC auctions during 1998 to date reflect the Government’s focus on revenue generation versus transfer of ownership from the state to the private sector:

1998 PPC Auctions:

- The average number of enterprises participating in monthly PPC auctions during the first seven months of 1998 was 266 - versus an average of 352 during 1996/97. 211 Groups B,C,D (medium/large) enterprises were offered monthly on average during the first seven months of 1998 - versus an average of 290 per month during 1996/97.
- The average number of new enterprises participating in PPC auctions during the first seven months of 1998 was 94 per month - versus 186 during 1996/97. 73 new Groups B, C, D enterprises were offered monthly on average during 1998 - versus 147 per month during 1997/98.
- Offerings in the July auction clearly reflect the pressure on the SPF to focus on cash auctions. Only 169 enterprises (the lowest number since January 1996) will participate in the July PPC auction. Only 61 enterprises will participate for the first time (the lowest number on record - excluding the first, limited pilot auction in January 1995). The value of statutory capital on offer in the July auction is the lowest ever.

1998 CC Auctions:

- The average number of enterprises participating in monthly CC auctions during the first six months of 1998 was 271 - versus an average of 371 during the second half of 1997.
- The average number of new enterprises participating in CC auctions during the first six months of 1998 was 122 - versus 185 during the second half of 1997.
- Offerings in the June CC auction reflect the pressure on the SPF to focus on cash auctions. While the total number of share packages being offered (224 - including 180 Groups B,C,D enterprises) is only somewhat below the average for all CC auctions, the number of enterprises

offering shares for the first time in a CC auction is 99, the fifth lowest number for all CC auctions to date. Most importantly, the nominal value of statutory capital on offer in the July auction is the lowest to date - excluding the first pilot auction in April 1996.

70%+ Sold Per Month:

As a result of the reduced offerings in PPC and CC auctions during 1998, the average number of enterprises reaching 70%+ sold via certificate auctions during the first six months of 1998 was 93 per month - versus 122 per month during the second half of 1997.

The average number of Group B,C,D enterprises privatized (by all means of sale) during the first half of 1998 was 105 per month - *versus an average of 274 per month during the second half of 1997.*

1998: A Watershed Year for Ukraine's Privatization Program

Despite the relative success of the mass privatization program to date, 1998 is - for the country's privatization/economic reform program - a watershed year.

Joint international donor collaboration will be required over the next several months to ensure that the highest levels of the leadership of the GOU (re)focus their attention on urgently undertaking the necessary measures to accelerate the mass privatization process in order to meet World Bank EDAL and IMF EFF privatization conditionalities.

Donor pressure and financing conditionalities produced a dramatic improvement in privatization results during the second half of 1997. This turnaround clearly indicated that the SPF/Cabinet/GOU - with political will and high level leadership support - can indeed accelerate the program. For example, versus the Compensation Certificate auctions during the first half of 1997, :

- The value of share packages offered in CC auctions during the second half of 1997 increased by more than 200%,
- The number of new enterprises offered increased by more than 60%,
- And the number of share packages offered increased by nearly 100%.

All of which resulted in a dramatic increase in the number of medium/large enterprises reaching 70%+ sold: from an average of 125 enterprises per month during the first half of 1997 to an average of 275 enterprises per month (and as high as 350 per month) during the second half of 1997.

Thus, at the end of 1997, USAID and the international donor community were confident that the SPF/GOU would - continuing the accelerated pace - be able to complete the mass privatization of all of Ukraine's medium/large industrial enterprises (except large agro-industrial/grain sector enterprises) by late 1998. And at the same time to introduce new tender procedures for large share packages in strategic enterprises in order to attract international advisors to conduct tenders for international strategic investors. However, with the GOU's rush to generate cash from privatization, continued acceleration of the mass privatization program and the introduction of new international standard tender regulations were quickly postponed in early 1998. Thus, in the first half of 1998, the mass privatization program - in terms of overall medium/large enterprise privatization targets - greatly slowed.

In mid-1998, with the impending end of its technical and financial support for mass privatization, USAID is losing both its leverage and its day-to-day influence on the program. Thus, the role of the World Bank and the IMF (and other bilateral and multilateral agencies) becomes much more critical both in terms of leveraging/pressuring the GOU to act and in terms of providing on-site, on-going technical/advisory assistance to the SPF and the Cabinet of Ministers.

“Cash” versus “Mass” Privatization

Since late 1997, the GOU (for legitimate reasons) has become obsessed with generating budget revenues from privatization. This new “strategy” has been very poorly implemented by the GOU/Cabinet of Ministers and the SPF - with disastrous results for both privatization revenue generation and for completion of the mass privatization program. Potential privatization revenues are not being generated and the GOU is falling further behind - month-by-month - in meeting the GOU/donor target to mass privatize (70%+ sold) the universe of 10,000 medium/large enterprises by the end of 1998.

In other words, the GOU may end the year having neither generated the maximum potential budget revenues from privatization nor secured new World Bank and IMF credits. The GOU/SPF have been very successful in meeting the World Bank's conditionalities for total number of medium/large enterprises 100% privatized and for the privatization of Ukraine's very largest enterprises. However, the GOU/SPF have been much less successful in privatizing by 70%+ each the entire universe of medium/large enterprises, in privatizing the grain distribution and processing sector, and in conducting tenders for international advisors to sell large share packages in strategic enterprises.

Obstacles/Opportunities

The SPF might argue that its generation of nearly UAH 250 million during the first five months of 1998 is proof of the success of its new "strategy" to focus on cash sales. These revenues have been generated from both stock exchange sales and commercial (cash) tenders - and are frankly greater than we had anticipated, particularly given the post-East Asia-crisis depressed market environment.

However, the SPF/Cabinet of Ministers/GOU fail to recognize that the GOU/SPF "strategy" is seriously flawed for the following reasons:

An estimated UAH 1.3 billion (exceeding the 1998 privatization budget revenue target of UAH 1.04 billion) could be generated by the SPF through the sale of only those share packages of 200 large and highly attractive enterprises - already allocated and approved for "cash sales" (via stock exchanges, commercial tenders or international tenders) - *at nominal value*. In other words, the GOU/SPF could offer - today - share packages of 200 attractive enterprises already approved for sale and (possibly) generate more than its 1998 revenue target. The shares of such enterprises can very likely be sold above nominal value and thus the revenue target far exceeded. *All that is required is the political will to do so.*

Instead of offering already approved for sale share packages of its largest and attractive enterprises and instead of selling large (26% or 51%) state shareholdings not planned for privatization in hundreds of large "strategic" (according to the GOU) enterprises, the GOU is hanging on to its major stakes in both share packages which are planned for sale and in share packages in the country's most attractive strategic enterprises (these are share packages which can be privatized now, they are not shares in telecoms, railway and atomic power enterprises which are currently on the Parliament's privatization "negative" list).

Share packages of hundreds of enterprises are being offered in cash auctions each month on local stock exchanges, the OTC market, commercial (cash) tenders and - beginning in July - in "mass cash" auctions via the Auction Center Network. While 15% of these enterprises are attractive enough to potential investors to generate the UAH 250 million in privatization revenues earned by the SPF during January - May 1998, the vast majority are unattractive and receive no bids.

Future Scenarios

The GOU/SPF leadership must - now - make some strategic decisions regarding Ukraine's second half of 1998 privatization program (and be prepared to strongly respond - as they should be prepared - to complaints from the Parliament that the GOU is selling the country's "crown jewels" at giveaway prices). The GOU/SPF can take one of the following routes during the remaining months of 1998:

1. Continue with the current "muddled" program:

- * Generate UAH 50 million in privatization revenues per month from stock exchange sales and commercial tenders.
- * Privatize (versus donor conditionalities) 50 to 100 medium/large enterprises per month.
- * Offer at or above nominal/book value - and fail to sell - hundreds of enterprise share packages each month.
- * Retain in state hands small (less than 5%) “leftover” share packages in more than 5000 enterprises.
- * Retain in state hands large (25%+) share packages in 800+ relatively attractive, privatizable enterprises.
- * *Fail to meet GOU privatization revenue targets for 1998. Privatize (70%+) only 8000 medium/large enterprises by the end of 1998. Retain unsold shares in thousands of enterprises into 1999.*
- * *As of today, the GOU/SPF is continuing to pursue its “muddled” privatization program. For example, as a result of SPF planning, in June:*
- * Only 230 enterprises will offer shares in the Privatization Certificate (PPC) auction with only 30 medium/large enterprises reaching 70%+ sold.
- * Only 19 medium/large enterprises will reach 70% sold in the June Compensation Certificate auction and (it is estimated) a similar number in the July CC auction.
- * Only 100 enterprise share packages will be offered in the first “mass cash” auction in July - which is intended to initiate the sale of leftover shares in more than 5000 unattractive enterprises (for a minimum of only UAH 10 per share package).
- * The SPF continues to offer hundreds of share packages via stock exchanges and cash tenders above nominal value.

2. Radically alter the current “strategy”:

Mass Privatization Program

- * Either offer all share packages allocated for cash sales (except packages in the 200 “top” enterprises) in cash auctions via the OTC market, stock exchanges or the auction center network to the highest bidder (with no floor price - as is permitted by the 1998 Privatization Program approved by Parliament).
- * Or (more effective option) offer all of these share packages in certificate auctions (where floor prices have also been eliminated).

Agro-Industrial Privatization Program

- * *Accelerate the demonopolization and privatization of Ukraine’s critical Agro-Industrial Monopolies:*
- * The state - as promoted by the Khib Ukrainy grain elevator monopoly - continues to retain 26% shareholdings in 342 grain elevators. These can be ordered to be sold - now - by the Cabinet of Ministers.
- * The state - via the Presidential Administration, the Cabinet of Ministers and the agro-“lobby” (including Khib Ukrainy management) are not demonopolizing the Agro-Industrial Complex (AIC) sector. The Prime Minister, the AIC Ministry and the Ministry of Industrial Policy are instead promoting and establishing new AIC holding companies and monopolies. In 1998, for example, “Ukragromashinvest” - which combines state shareholdings in all farm equipment manufacturers into one holding company - was formed. At the same time, the GOU continues to promote and enhance the stranglehold of Khib Ukrainy, “Ukragrokhim” (fertilizers/chemicals), “Ukragrotechservis” (equipment supplies) and other renamed and reconstituted state monopolies/holding companies in the AIC sector.

- * These AIC monopolies/holding companies are not being forced upon the GOU by the Parliament. Rather, they are being promoted by the GOU (as are new holding companies in the oil and gas sectors).

Tenders

- * Actually implement the recently adopted (by the SPF) regulations for tendering for (international) advisors and for tenders for the sale of large share packages in strategic enterprises - for the 25 to 50 most attractive enterprises, i.e. attract international advisors and investors to manage the sale of/invest in Ukraine's most attractive privatizable enterprises.
- * The adoption in early July by the SPF of the regulation on the selection of advisors via competitive tender and the regulation on the sale of large share packages via competitive tender - with winning bidders able to negotiate contracts to manage remaining state shareholdings - is a very positive development in terms of the GOU taking its first steps to attract reputable international investment banks and strategic investors to invest in Ukraine's largest and most promising enterprises.
- * The regulations as adopted by the SPF meet the requirements of the international donor community, coincide with internationally acceptable tender standards and procedures, are very transparent, generally take subjective considerations by the SPF out of the competition - and give the advisors the authority to evaluate bids, and eliminate up-front, bridge financing and "bid guarantee" requirements which destroyed the effectiveness of the SPF's December 1997 international tender regulations. The SPF management is determined to utilize the new regulations in the sale of strategic enterprise share packages this year.
- * As it is apparent that the state (given its poor track record) can provide no better value-added through its management of large, controlling interests in several hundred "strategic" enterprises than domestic and international private sector investors, it is time for the state to sell these shares - with the assistance of international advisors for those few most marketable enterprises. Otherwise, sell the rest for cash via stock exchanges and cash tenders.

One of the major strategic mistakes being made by the GOU/SPF concerns the notion that hundreds or thousands of enterprises need to be sold for cash in order to raise the required (by the 1998 Privatization Program) UAH 1+ billion in privatization revenues before the end of the year. The danger in this assumption is that quantitative targets (9,500 privatized by the fall of 1998) will not be met, while qualitative targets (UAH 1 billion revenues) will also be difficult to meet - given the ineffectiveness of cash privatization thus far and the low quality of the enterprises being offered for cash sales.

- The SPF can focus its efforts on a small number of enterprises which could be sold for cash this year and generate the needed UAH 1 billion. The rest of the enterprises should be sold primarily through mass privatization means - preferential sales, free transfers, and certificate auctions.
- A short list of enterprises, which are in the share sales process, which have unsold shares allocated (via *approved* share allocation plans) for cash sales, and which together would raise UAH 1.3 billion (with 80% of proceeds going directly to the budget), if they sold the full allocation for cash at *nominal value* - has been prepared.
- The list includes enterprises which:
 - * have data in the SPF's "ETAP" privatization database;
 - * have begun share sales - i.e., have approved share allocation plans;
 - * have cash sales (tenders, stock exchange sales, cash auctions) included in their share allocation plans;
 - * have the highest book value of shares allocated for cash;

- * and for which no additional approvals, compromises, or deals are needed to conduct these sales. Share allocation plans have been approved and sales may thus be conducted by the SPF without further delay.

The 1998 strategy of the SPF/GOU is to offer as many share packages as possible for cash via stock exchanges and “commercial” (cash) tenders and, beginning in June, cash auctions via the Auction Center Network. This strategy has produced the following results over the past five months:

1. The number of enterprises privatized (more than 70% sold) each month has plunged disastrously from more than 300 per month last summer to fewer than 100 per month over the past four months.
2. Cash sales - via stock exchanges and tenders - have produced disastrous results. Share packages are not being sold because, in most cases, the enterprises are unattractive and investors have no interest at any price. These share packages should be quickly sold in certificate auctions. Otherwise they will never be sold.
3. Share packages of more attractive enterprises are not being sold because the SPF offers the shares at nominal value or, more commonly, at several times nominal value. These share packages should be sold to the highest bidder - with no minimum price. Otherwise they will never be sold.
4. As an example of this disastrous strategy, the results of the SPF's offerings of share packages on stock exchanges in May 1998 indicate that: Of the share packages offered on seven local stock exchanges, shares of only 13% of share packages offered were partially or wholly sold. Nearly all share packages were offered with a floor price at or above nominal/book value.
5. Because these share packages are allocated for cash sales via stock exchanges (with unrealistic floor prices), they will never be sold for cash - and will not be offered in certificate auctions. Which means that World Bank and IMF conditionalities will not be met.

International Donor Assistance

It is very clear that, although Ukraine's mass privatization program will reach near-completion by the end of the year, there will be much unfinished business in terms of completing privatization of all medium/large enterprises, selling all remaining state shares/full privatization of the country's most important industrial/agro-industrial enterprises, transitioning from privatization to restructuring of viable enterprises, bankruptcy and liquidation of hundreds of large enterprises, and development of an environment conducive to the rapid growth of newly created small and medium-sized enterprises.

Thus, international donor technical and financial assistance commitments are required now to ensure that the results of USAID's investment in the mass privatization program over the past five years can effectively serve as the basis for new donor initiatives to see Ukraine through completion of the first stage of its privatization program, through demonopolization and privatization of the grain processing and distribution industry (and other AIC sectors), and through the conducting of international tenders for controlling interests in strategic enterprises.

Limited but experienced, senior level international donor advisory assistance will be required to provide the GOU with the international experience necessary for it to successfully conduct tenders for international advisors and strategic investors in Ukraine's 200 largest and most important (to the

economy) strategic enterprises including the telecommunications monopoly (the GOU hopes to obtain Parliament's approval to privatize Ukrtelecom this summer).

PRIVATIZATION OF UKRAINE'S LARGEST ENTERPRISES

Summary

Despite the fact that Ukraine's privatization program has been beset by political obstacles, delays, and controversy, the vast majority of Ukraine's very largest state-owned enterprises have been partially to wholly privatized. The Verkhovna Rada's (Parliament's) attempts to block privatization by way of issuing a list of enterprises prohibited from privatization (the "Negative List"), privatization moratoriums, and other legislative obstacles over the past four years have proven to have little impact on the overall success of the program.

Some problems of course do persist, such as the Government's reluctance to sell 100% of the state's shareholdings in its largest enterprises, the lengthy privatization process for each large enterprise, and government interference in the day-to-day operations of such enterprises. Nevertheless, as the following numbers indicate, a convincing groundwork for the complete privatization of Ukraine's very largest enterprises has been established.

Background

In August 1998, the *Ukraine Investment Newspaper* published the lists of Ukraine's largest and best-performing enterprises according to their 1997 financial results. These enterprises were selected on the basis of five criteria: output, pre-tax income, market capitalization, export volume, and number of employees. The lists were compiled utilizing Ministry of Statistics data and were reviewed and verified by Deloitte & Touche and utilized by the PwC Mass Privatization Project team.

Combining these five lists, a list of Ukraine's 200 largest, strategic enterprises was created (with the top 200 being those which were ranked the highest and appeared on the most number of lists).

The Top 200 list of enterprises excludes new enterprises which were never state-owned (e.g., Privatbank) and foreign joint ventures (e.g., Ukraine Mobile Communications)

The Top 200 lists includes open and closed joint stock companies (JSCs) privatized before 1995 (e.g., Nord Appliances), enterprises privatized since 1994 (the mass privatization program began in January 1995), state enterprises converted to open JSC status and undergoing privatization, and state-owned enterprises currently prohibited from privatization.

For analytical purposes, these 200 enterprises have been divided into two major sub-groups:

1. those state enterprises prohibited from privatization by Parliament;
2. those state enterprises privatized or undergoing privatization;

The Top 200 Enterprises

The "Top 200" privatization status analysis was conducted utilizing official data from the *Ukraine Investment Newspaper*, the State Property Fund (SPF), the Ukrainian Center for Certificate Auctions (UCCA) and the PwC Mass Privatization project's data available as of August 15, 1998.

Privatizable enterprises vs. enterprises prohibited from privatization:

- Only 32 enterprises (16% of the top 200) are prohibited versus 168 which are subject to privatization.

Privatization Status of Privatizable Enterprises

Of Ukraine's 168 largest privatizable enterprises from the Top 200 enterprise list:

- 35 enterprises are preparing for share sales;
- 29 have sold less than 25% of their shares (i.e. are still state controlled);
- 40 have sold more than 25% but less than 50% of their shares (i.e. the private sector holds a major but less than controlling interest);
- 37 have sold more than 50% but less than 100% (i.e., the private sector holds a controlling interest);
- 27 are 100% sold.

State Shareholdings

According to the share sale allocation plans for the 118 enterprises which are now undergoing share sales, the state is planning to hold less than 50% share packages in each of 103 (87%) of these enterprises from the Top 200 list. In some industries such as food processing, cement, metallurgy, and chemicals, the state has already sold the majority of its shareholdings. At the same time, the state intends to retain for the foreseeable future 25% or 51% stakes in each electric power company.

Types of share sales

- 98 of the Top 200 enterprises (or 74% of those which have begun share sales) have participated in certificate and mass cash auctions. 29 of the Top 200 enterprises sold up to 78% of their statutory capital in Privatization Certificate (PPC) auctions in 1995 and up to 30% of their statutory capital in Compensation Certificate (CC) auctions in 1995. In 1998, 13 Top 200 enterprises sold up to 6.8% of their statutory capital in PPC auctions and up to 3.8% of statutory capital in CC auctions.
- 61 Top 200 enterprises have sold shares via Stock Exchanges and the OTC market. 14 enterprises sold up to 10% of their shares in 1997. 47 enterprises have sold up to 22% of their shares in 1998 to date.
- 47 Top 200 enterprises (28% of the 168 privatizable enterprises and 35% of those which have begun share sales) have participated in sales via tenders. 17 enterprises offered up to 52% of their statutory capital in tenders in 1997 and 25 enterprises offered up to 51% of their shares in tenders in 1998 to date.

Top 200 Privatizable Enterprises' versus Prohibited Enterprises' Output and Exports

The Top 200 by Output

According to data published in the *Ukraine Investment Newspaper* and Ministry of Statistics data, the privatizable/privatized enterprises on the Top 200 list generated 75% of Ukraine's GDP in 1997. To put this into perspective, this means that a fraction of 1% of all medium and large enterprises in Ukraine account for three-quarters of the country's total (reported) output.

Enterprises prohibited from privatization (primarily telecoms, railroads, and atomic power plants) contributed 11% of GDP. Enterprises not on the Top 200 list contributed the balance, 14%, to Ukraine's GDP last year.

The Top 200 Exporters

According to the *Ukraine Investment Newspaper* and Ministry of Statistics' data, the privatizable/privatized enterprises on the Top 200 list, accounted for 64% of the country's total export volume in 1997. The number of prohibited enterprises among the largest exporters and their aggregate export volume in 1997 was insignificant – only 3% of total exports. Enterprises not on the Top 200 list accounted for 33% of Ukraine's 1997 exports.

Conclusions

- **168 enterprises among Ukraine's Top 200, representing 75% of Ukraine's GDP, are undergoing privatization, i.e. nearly all are in the process of privatization or have been fully privatized.**
- Other than telecommunications (which is expected to begin privatization in 1998), no major privatizable enterprises/sectors are currently prohibited from privatization; prohibited enterprises' contribution to Ukraine's GDP and to the country's overall volume of exports is small compared to those enterprises which are subject to privatization.

Government Plan to Transfer Uncollected Compensation Certificates to State-Owned Investment Companies (“Derzhinvest” and “Finprom”)

[NOTE: The following two pages provide a summary of a plan developed by the Ministry of Industrial Policy and officials in the Cabinet, approved by the Prime Minister and the President, and implemented in August 1998. The plan provides for the transfer to two state-owned investment companies of all Compensation Certificates not collected by the public as of July 1.

While the plan was officially described by its promoters as a means to raise revenues for the state budget to be used to compensate citizens for lost savings, by mid-August it became apparent that the plan has different aims. In fact, the Cabinet ordered the State Property Fund to offer 25% share packages in each of 81 of Ukraine’s most attractive, blue chip enterprises in the August Compensation Certificate auction. The two state-owned investment companies will then purchase these shares via intermediaries. These shareholdings – combined with other large shareholdings retained by the state – will provide the investment companies with controlling interest over the blue chip enterprises.

In essence, it would appear that certain officials in the Government intend to expand the role of these state investment companies as long-term shareholders and managers of key enterprises. These investment companies will thus become large state-owned holding companies.

The reason for our including this analysis in our final report is that the plan to indirectly transfer attractive shares (which could be sold to strategic investors) to government agencies is representative of the government’s backtracking on its own economic reform initiatives. While some Government ministries and agencies are promoting privatization and market reform, other ministries and agencies are undertaking steps that serve to undermine the reform program.

Since independence in 1991, the Government (and the Parliament) have displayed a penchant for creating new state organizations established for supposedly progressive aims – but in reality serving only to impede and delay urgent reforms and to provide employment for more bureaucrats. We have witnessed such developments in the agro-industrial sector and in other strategic industries.]

The Plan as Described in the President’s Decree and in the Cabinet of Ministers’ Resolution

On March 27, 1998, President Kuchma issued the Decree “On Additional Actions to be Taken Regarding the Compensation for Losses Incurred by Citizens as a Result of the Devaluation of their Savings in the Savings Bank of Ukraine and in Oranta (the State Insurance Company)”, a Decree which recently became law (the Parliament failed to overturn the Decree within the legal deadline). The Decree was initially proposed by the Ministry of Industrial Policy.

The Decree and subsequent resolution of the Cabinet of Ministers provide for the transfer to government agencies of all Compensation Certificates which have not been collected by citizens as of the July 1, 1998 deadline for collection. The Decree states that the Compensation Certificates are to be transferred to selected “authorized persons”.

The Cabinet of Ministers’ Resolution of June 5, 1998 specifically appoints the state investment companies, *Derzhinvest* and *Finprom* (a state investment company newly created by the Ministry of

Industrial Policy), as the authorized persons. Derzhinvest is to receive all Compensation Certificates held by “Oranta”, the state insurance company (for which Derzhinvest manages the state’s shareholdings). Finprom is to receive all certificates held by the Savings Bank. These state agencies are empowered to participate in the privatization process through the purchase of shares of state-owned enterprises offered in Compensation Certificate auctions.

According to the “explanatory notes” to the President’s Decree, the State Property Fund is to increase the share allocation quotas for Compensation Certificate auctions for 399 of Ukraine’s largest and most attractive enterprises which are undergoing privatization. The proposed list includes the largest enterprises for which privatization is being managed by the State Property Fund’s Central Office (as opposed to the SPF’s regional branches), including electric power, steel, chemical, alumina, machine building and other heavy industrial enterprises. Shares of these enterprises are to be offered beginning with the August Compensation Certificate auction.

Derzhinvest and FinProm are to then sell these shares in the secondary market for cash. Cash proceeds equivalent to the book value of the shares sold are to be transferred to the state budget and partially used to compensate citizens for lost savings. Any proceeds above book value are to be lent to or invested in troubled enterprises. Derzhinvest and Finprom are to act as investment funds and bankers with interest on loans and loan repayments reinvested in shares via the secondary market and with earnings from share trading used to make new loans to enterprises.

Newly Appointed Derzhinvest Supervisory Board

On May 26, the Prime Minister signed and issued Cabinet of Ministers’ Resolution #749. The Resolution appoints a new Supervisory Board for Derzhinvest to include the following officials:

Mr. Germanchuk, Supervisory Board Chairman and First Deputy Finance Minister
Mr. Kruykov, Deputy Supervisory Board Chairman and Acting Chairman of the SPF
Mr. Musgovy, Securities Commission Chairman
Mr. Bondar, First Deputy Governor of the NBU,
Mr. Visslohub, Deputy Minister of Foreign Economic Relations,
Mr. Grigorenko, Director of the Economic and Social Policy Dept of the Presidential Administration,
Ms. Kuzhel, Chair of the State Entrepreneurship Committee,
Mr. Litvitsky, Assistant to the President,
Mr. Medoliz, Deputy Chairman of the Nat’l Agency for Reconstruction and European Integration,
Mr. Petrashko, Deputy Finance Minister and head of the Treasury Dept,
Mr. Sorokin, Chairman of the Eximbank,
Mr. Shevchuk, First Deputy Minister of Economy.

Issues Raised by the Transfer of Compensation Certificates to State Investment Agencies

The transfer of uncollected Compensation Certificates to - and their investment in share auctions by - Derzhinvest and Finprom not only undermines the certificate auction program during its final six months but also violates the principles of the mass privatization program.

Firstly, the sale of state-owned shares via specially appointed state intermediaries will not lead to an increase in budget revenues to be used for the compensation of citizens’ lost savings. More likely, revenues generated via this scheme will be less than those which might be generated through the direct sale for cash of the shares of many of Ukraine’s largest and most promising enterprises. The

creation of an additional layer of intermediaries between the State Property Fund and the ultimate investors in the shares will also further impede the pace of privatization.

Secondly, privatization of Ukraine's state-owned enterprises via the auctioning of shares for Compensation Certificates is being replaced by the indirect transfer of state-owned shares from one government agency (the State Property Fund) to others (Derzhinvest and Finprom). This would appear to not only delay privatization but to reduce the authority of the State Property Fund to conduct privatization.

Thirdly, concentration of some 80% of all Compensation Certificates in the hands of two government agencies will effectively eliminate the opportunity for private investment funds (and of course individuals who intend to invest their certificates directly in auctions) to acquire shares in Compensation Certificate auctions. As a result, public confidence in Ukraine's privatization program will be undermined as it becomes known that the state is using the certificate auction program to transfer shares in state-owned enterprises to other state agencies.

More specifically, the original concept of Compensation Certificates - as a means to compensate citizens for lost savings, to promote public participation in the mass privatization of Ukraine's industry, and to allow for the rapid sale to the private sector of all shares offered in Compensation Certificate auctions (with no floor price) - will have been violated. The above developments are incompatible with the principles of the mass privatization program as originally agreed between the governments of Ukraine and the international donors.

All certificates not collected by Ukrainian citizens were to be canceled and destroyed - following the deadline for collection - in compliance with the established procedures governing their use.

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[NOTE: Following are highlights of an interview with the Director of “Finprom”, one of the two state-owned investment companies which are acquiring large shareholdings in large and attractive enterprises undergoing privatization via the August 1998 Compensation Certificate auction.

We have included these highlights because they clearly indicate the intention of Finprom (to be a long-term strategic investor in many of Ukraine’s blue chip enterprises and to play an active management role in such enterprises).

The interview also provides some insight into the thinking of many Ukrainian government officials who believe that they – versus new international and domestic owners from the private sector – can provide the solutions to Ukraine’s economic woes.]

From the “Investment Gazette”, Kyiv, August 18, 1998.

Commentary

Finprom’s director Alexander Avdoshkin thinks that his agency will be able to serve as a magic bullet for domestic industry.

- Did you already receive the Compensation Certificates? In what amount?

- As of August 12, 1998, *Finprom* had received UAH 2,155,000,000 worth of CCs. The CC transfer mechanism was determined by the Cabinet of Ministers’ Resolution “On the approval of the procedures for transferring the compensation certificates not collected by Ukrainian citizens to authorized persons” #1001 of July 2, 1998.

- In your opinion, are the share packages to be purchased by Finprom formally owned by the state? What is their legal status?

- *Finprom* will purchase share packages through professional securities market traders participating in specialized CC auctions. So these packages will actually be owned by the state and will come under the full management of the state-owned enterprise *Finprom* while our activities will continue to be controlled by the Investment and Clearing Committee of the Ministry of Industrial Policy of Ukraine.

- Are you going to invest in enterprises by providing loans or by other means? Have you already developed legal documents regulating these issues? What enterprises are you already cooperating with on this matter?

- To date we have already established links with all enterprises to be offered for sale during the 29th CC auction and are actively studying their current financial situation, potential, investment needs and prospects for development. This activity will help us develop the sequence in which the enterprises’ share packages should be offered for sale as well as to identify the most attractive assets in which to invest.

With our experts’ experience and knowledge, we are planning to take an active part in additional share issues by the enterprises in question and adopt new - for Ukraine - schemes of capital attraction (including issuing ADRs, GDRs, certain types of bonds, attracting foreign credits guaranteed by financial assets, etc.). This will allow us to increase the efficiency of production and, at least to some extent, overcome the issues of inter-company payment defaults and unpaid wages.

Additionally, the mathematical tools developed by *Finprom* specialists, make it possible to optimize (streamline) commodity flows, which, in turn, will allow us to considerably reduce unproductive expenditures and accelerate the process of mutual settlements in a given economic sector.

- In which way are you planning to take part in management and business activities of the enterprises?

- There is no doubt the above steps will be impossible unless we are actively engaged in the process of management of the enterprises. Therefore, our strategy provides for three stages of interaction with enterprises. During the first stage, we will simply be using the corporate rights of a major shareholder (establishment of working relationships with management, profound analysis of problems related to the financial situation and economic activity of the enterprise). During the second stage, we will propose schemes to resolve problems, provide consulting support for investment project financing, purchase newly issued shares etc. During the third stage, it is planned to create and implement an integral system of formalized financial management of each enterprise, which may be achieved by utilization of the multi-user computerized system of automated management in the "JENSIM-2" environment. To develop the most efficient financial flows, we will attract corresponding industry experts.

Epilogue

Interview with Alexandr Paskhaver, Advisor to the President of Ukraine on Economic Policy And Designer of the Original Concept of Mass Privatization in 1992

August 12, 1998

Question (Kevin Covert, PricewaterhouseCoopers privatization consultant): When you and a small group of policy advisors gathered in 1991 to discuss the question of privatization in Ukraine, what was your starting point? Did you have a basic philosophy?

Answer (Alexandr Paskhaver): We knew for certain that the population at large was against the privatization of land, the privatization of small businesses, etc. In fact, we were forbidden from using the word, “privatization” in our drafts of new legislation. We were interested from the very beginning in designing a program that would educate people and get the entire population involved in the privatization process. The concept of “mass privatization” thus formed the basis for our approach.

Our focus from the very beginning, in fact, was more socio-political than economic. The primary objective was to transfer ownership in Ukraine’s enterprises from the state to the private sector. The Government’s privatization program is often criticized for not generating revenue for the budget, but these critics overlook a fundamental point: the program was not designed to raise cash for the budget or to improve the economic effectiveness of enterprises. It was designed to get these businesses out of state control and into the hands of private owners.

KC: Did you run into any opposition when you began to put your ideas into practice?

AP: Naturally, the Communists and Socialists weren’t too happy with the first privatization laws we drafted. They supported economic reform based more on the Chinese model or on Gorbachev’s idea of a “new and improved socialism.” The very idea of private ownership was under attack, so getting Parliament to vote for private sector development free from government influence was not easy.

KC: How did you manage it?

AP: First, we were fortunate that the Parliament was itself divided on the issue. Had there been a united left “front” against us, it is likely that privatization in Ukraine would not have started when and how it did. Second, we were able to convince a few influential Parliamentary deputies to lobby for privatization – and they were successful.

KC: It sounds like you didn’t have the luxury of time in the early days of privatization.

AP: We were under unbelievable pressure. For an entire year, we worked day and night to push our ideas through the system. There was a constant sense that the entire economic reform process might come to a halt tomorrow.

KC: Looking back now, with the benefit of hindsight, is there anything you wish you had done differently?

AP: Yes. We made one major mistake. We underestimated the extent to which the new bureaucratic system would become an obstacle to private sector development. We did not realize that the biggest threat to privatization was something outside the privatization process: the system itself. Under the Soviet command economy, the bureaucracy reported to the Communist Party and

served the interests of the Party. While this arrangement may not have been good for the economy, at least there was some discipline and logic to the system. With the collapse of the Soviet Union, however, a new administrative system developed and began to grow – and it was not subordinated to anything else. As a result, economic reforms were more difficult to implement on a national scale. While there was support for privatization at the highest levels of government, mid-level bureaucrats nevertheless threatened to paralyze the entire process – and they often succeeded.

KC: Are there any other “lessons learned” that you would like business and government leaders in other countries to know about?

AP: We had to design a privatization program that required neither time nor money. It had to be done fast and cheaply – and on a mass scale. And we could not simply sell enterprises for cash, because we knew that there were very few domestic investors willing and able to pay cash for shares in state-owned enterprises. As a result, we turned to the voucher-based privatization scheme, which was used successfully in Russia. The idea was to transfer ownership from the state to the private sector as fast and as efficiently as possible. In this sense, vouchers worked beautifully: we liberated 60,000 small- and medium-sized enterprises from state ownership and control.

But we failed to follow up on this achievement. We thought that once the shares were “sold” for vouchers, we would see the beginnings of a secondary market, with domestic and foreign capital attracted to Ukraine’s private industry. Unfortunately, while the voucher system was effective in helping us to achieve the main goal of privatization, it did not lead directly to the creation of an active capital market as we had hoped. Mass privatization fostered the wide distribution of shares among hundreds of different owners. These shares have not yet been acquired and consolidated by investors interested in managing the enterprises. Today, six years after Ukraine declared its independence, we are still waiting for private investors to enter the Ukrainian market.

KC: On the whole, would you say that privatization in Ukraine has been a success?

AP: Measured against our initial objective, yes. We were successful in getting the state out of the business of running businesses. With the help of PricewaterhouseCoopers, the Government of Ukraine has privatized nearly 8,000 medium- and large-scale enterprises, including some of the most profitable and attractive enterprises in the country.

KC: What is your opinion of the current investment climate in Ukraine? Are you optimistic that the situation will improve?

AP: This is the first year since independence that I’ve seen market mechanisms beginning to work. Certain sectors – pharmaceuticals, metallurgy, food processing – are showing real growth, a rise in demand, and the beginnings of enterprise restructuring. This is, of course, just the beginning, but it is happening and, fortunately, without fanfare.

KC: One issue that most investors agree has been a deterrent to entering the Ukrainian market is the high rate of taxation. What do you think of Ukraine’s taxation system?

AP: This is certainly a problem, for investors and the Government alike. I recently recommended to the President that he establish a Council for the Support of Entrepreneurship. The Board of Directors of this new Council should be composed of representatives of private companies that have the most debt outstanding to the Government. Given their own experience and background, they will certainly have an interest in supporting entrepreneurs. In exchange for their support of private businesses, the companies on the Council would be granted a discount on the taxes they owe – say, 10 percent. I also recommended that the Board composition be changed every two years, so that different companies will have an opportunity to participate.

KC: Another issue that has a negative impact on the investment climate is the amount of corruption in Ukraine's economy. Could you please comment on that?

AP: Corruption is not a problem. It exists, but in and of itself, it is not a problem. The problem is that government officials are not interested in adding value to the enterprises they own or control. They do not increase the value of their "shareholding." They just milk the enterprise until it runs dry.

There are some problems with Ukraine's economy, but in general, I am optimistic that economic reform in Ukraine will continue to produce positive change.

OVERVIEW OF THE PRIVATIZATION PROCESS IN UKRAINE: HOW DOES UKRAINE'S PRIVATIZATION PROGRAM WORK?

The following is a brief description of some of the core aspects of Ukraine's privatization program. It seeks to answer general questions regarding the program's most important "nuts and bolts".

Objects for Sale

The mass privatization program encompasses all medium-sized and large state-owned enterprises with fixed assets worth at least UAH 1mln (approx. \$500,000). Small-scale enterprises (e.g. retail establishments), unfinished construction sites, and joint ventures are included in separate programs. According to the State Privatization Program, "mass" objects include three basic groups: Group B – labor intensive, medium-sized enterprises (fixed assets > UAH 1mln with a high ratio of employees to fixed assets); Group C – capital intensive, medium-sized enterprises (fixed assets > UAH 1mln with low ratio of employees to fixed assets); Group D – large enterprises (fixed assets > UAH 170mln, monopolies, military-industrial complex, enterprises with foreign investment).

While specific parliamentary approval for a given enterprise's privatization is not required, the Parliament may prohibit privatization – and it does so via the so-called Negative List, which currently lists approximately 2500 state entities which are explicitly prohibited from privatization (the most important industries on the current Negative List are telecoms, railroads and atomic power). In addition, the Law on Large-scale Privatization defines the industries, which are deemed too important for the State to privatize (e.g., oil & gas pipelines) as well as the social sectors (e.g., public education) and government branches (e.g., ministries) which are not subject to privatization. Parliament is the only body which can officially prohibit privatization, although executive orders can also cause certain (indefinite) delays.

The total universe of medium and large-sized enterprises is approximately 14,000. Of these, the total number of prohibited enterprises approximates 2,500. Thus, the universe of privatizable/privatized medium and large enterprises is 11,500. Approximately 1500 of these enterprises were privatized prior to 1995 when the mass privatization program was initiated. Thus, approximately 10,000 enterprises are subject to mass privatization.

Asset Valuation

Valuation of to-be-privatized assets is mostly based on an evaluation of their book value, subject to specific procedures and various rounds of "indexation". In special cases, so-called expert valuation may be ordered, in which case additional factors, such as market value and other intangibles, are also taken into consideration. Expert valuation is generally conducted by licensed Ukrainian accounting firms, while mass (asset) valuation is most often performed by the State Property Fund of Ukraine (SPFU) itself. The Cabinet of Ministers of Ukraine determines valuation procedures, while the SPFU designs implementation instructions.

Enterprise Preparation

Before privatizing, each state-owned enterprise must go through a standard set of preparation procedures. These procedures include the following seven steps:

Decision on privatization – the SPFU must authorize the company to begin privatization.

Establishment of the Privatization Committee – this is the body which manages the day-to-day aspects of privatization of the company; it consists of representatives from the enterprise, the SPFU, the Anti-Monopoly Committee (if relevant), and the relevant branch ministry.

Preparation – the transformation of the state-owned enterprise into an open joint-stock company (OJSC), including valuation, an independent audit, and preparation of the company charter and privatization plan (including share allocation plan).

Privatization Plan (Share Allocation Plan) and Charter Approval – the share allocation plan must be approved by the SPFU and, in some cases, agreed with the Cabinet of Ministers and the branch ministry.

Conversion and Registration of the OJSC – the newly corporatized entity must be registered with the State Statistics Committee.

Registration of the Share Emission – the newly emitted shares must be registered with the State Securities and Stock Market Commission. Agro-industrial enterprises must undergo a second audit during this phase.

Creation of Share Sales Committee – the Privatization Committee is disbanded and the Share Sales Committee is established, often with a similar make-up as the Privatization Committee.

These procedures should take two months to complete, although in many cases, especially for the larger enterprises and those with poor accounting records, the process can take 6+ months.

Allocation of Shares

Allocation of shares is defined in the enterprise's share allocation plan (SAP), which is an integral part of the enterprise's approved Privatization Plan. The SAP is developed by the enterprise's Privatization Committee, which consists of representatives from the enterprises, the SPFU, the Anti-Monopoly Committee (if relevant), and the branch ministry. A typical SAP includes an allocation for preferential sales and for Privatization Property Certificate Auctions and/or Compensation Certificate Auctions (up to the quota defined in the Privatization Program), with the rest divided among the various forms of cash sales. Aside from the preferential sales formula and the certificate quotas, no strict guidelines exist for determining share allocations – and is thus left entirely to the discretion of the Privatization Committee. SAPs for Group D enterprises and all agro-industrial enterprises must be agreed with the Cabinet of Ministers of Ukraine. All others are subject only to SPFU approval.

Methods of Sale

New methods of sale are subject to parliamentary approval – i.e., they must conform to the principles of the Law on Large-scale Privatization and the State Privatization Program. In accordance with the most recent versions of the Law and the Program, the following methods of sale are envisioned:

Preferential Sales (Closed Subscription) – sale to employees and managers of the privatizing entity. Managers receive up to 5% of shares in exchange for cash and an additional 5% in exchange for Compensation Certificates (provided full compliance with privatization preparation procedures). All employees have the right to purchase up to UAH 750 worth of shares at par value (UAH 500 in exchange for Privatization Property Certificates and an additional UAH 250 in exchange for cash). Military veterans and other selected individuals might also participate in preferential sales of their choice (but only once). Agro-industrial enterprises have an additional, unique form of preferential sale whereby 51% of all shares are transferred for free to suppliers (collective farms).

Privatization Property Certificate (PPC) Auctions – sale to the public via an open auction conducted by the Certificate Auction Center Network (CACN). Participation is limited to holders of Privatization Property Certificates (PPCs) and financial intermediaries. The latter may submit priced bids (i.e., with maximum price limits for the to-be-purchased shares). Bids must be submitted during a one-month period and shares are distributed pro rata among all winning bidders commensurate to the PPCs they bid.

Compensation Certificate Auctions – sale to the public via an open auction conducted by the Certificate Auction Center Network (CACN). Participation is limited to holders of Compensation

Certificates (CCs) and financial intermediaries. The latter may submit priced bids (i.e., with maximum price limits for the to-be-purchased shares). Bids must be submitted during a one-month period and shares are distributed pro rata among all winning bidders commensurate to the CCs they bid.

Cash Auctions – conducted by the Certificate Auction Center Network, “mass cash” auctions were initiated in July 1998. Monthly auctions are held for entire share packages of remaining state shares. There is no minimum/floor price. Share packages are sold to the highest bidder.

Stock Exchange Sales – sales for cash on one of Ukraine’s five stock exchanges. The SPFU sets minimum/floor prices. Shares are sold in blocks for cash to brokers owning seats on the relevant exchange or via the OTC market.

Commercial & Non-Commercial Tenders – sale of a large block of shares for cash. In a commercial tender, the winner is the bidder offering the highest price for the cash purchase of the share package – with the assumption of fixed future investment obligations. In a non-commercial tender, the winner is the bidder offering the highest net present value investment plan – with the price for the up-front, cash payment for the share package fixed. Future investment obligations usually involve capital investment and repayment of existing short-term liabilities. Such tenders involve the largest (Group D) enterprises and large share packages of 25% or more of the total shares of each enterprise.

Strategic Enterprise Tenders – sale of large blocks (25%+) of shares, with the help of international advisors, to strategic investors via international tenders or IPO’s. In addition to the use of advisors, the main difference between strategic enterprise tenders and commercial/non-commercial tenders is that the former are generally used for Ukraine’s blue chip/strategic enterprises, while the latter are used for enterprises with a smaller, more domestically-oriented investor market. Also, strategic enterprise tenders are conducted in one round, while commercial/non-commercial tenders are conducted over two rounds.

Means of Payment

Currently, there are three accepted means of payment for shares in privatizing enterprises: cash, Privatization Property Certificates (PPCs), and Compensation Certificates (CCs). Means of payment are always defined in the enterprise’s share allocation plan. PPCs are issued one to each citizen (as registered in the 1991 census) and must be collected at the National Savings Bank (Oschadny Bank). The purpose of distribution of PPCs is to give each citizen of Ukraine the right to share in the distribution of state owned assets. PPCs are registered securities, each with a face value of UAH 500. CCs are distributed to each citizen who had a balance in his/her savings accounts at the National Savings Bank (Oschadny Bank) and/or the National Insurance Company (Oranta) on January 1, 1992. The purpose of CC distribution is to compensate citizens for savings they lost during the period of hyperinflation (1992-94). CCs are bearer securities (i.e., freely tradable – and available for use by anyone, i.e. foreigners may purchase CC’s in the secondary market and invest them in CC auctions) and have a face value of either UAH 10 or 20.

Sellers

The State Property Fund of Ukraine (SPFU), an executive branch of the government which, during the process of privatization, acts as the owner and seller of all state property on behalf of the Cabinet of Ministers. The SPFU is headquartered in Kyiv and has regional offices in every provincial capital. Municipal property (separate from state property) is sold by municipal authorities, with assistance from Communal Property Funds. Most medium-sized and large enterprises however, are privatized by the SPFU network as state property. Branch ministries, the Anti-Monopoly

Committee, and the State Securities and Stock Market Commission also play a role in the process. To implement the sales, the SPFU may also make use of third parties, such as Ukraine's stock exchanges and the Certificate Auction Center Network.

Buyers

According to the Law on Large-Scale Privatization, virtually everyone (individuals and legal entities) is a potential buyer in Ukraine's privatization process. Preferential Sales are limited to those with preferred rights. Foreign individuals and legal entities are excluded from direct participation in Privatization Property Certificate Auctions (but may participate through financial intermediaries), but may participate in all other privatization sales, including sales of shares in Ukraine's largest enterprises to strategic investors. With the exception of preferential sales, in all sales mechanisms investors may participate either directly or via intermediaries.

Intermediaries

Intermediaries may submit bids for shares in all forms of share sales other than preferential sales. Intermediaries include investment funds, investment companies, and trust companies (including banks).

Advisors

The State Property Fund of Ukraine (SPFU – the seller) may engage third-party advisors at any time during the enterprise preparation and share sales stages. Advisors must be selected through a competitive tendering process regulated by SPFU procedures.

CERTIFICATE AUCTIONS

What are certificate auctions?

A certificate auction is the open sale of shares in medium-sized and large state-owned enterprise for “privatization papers”. Certificate auctions are held simultaneously, usually for several hundred enterprises, in every region of Ukraine. They consist of three stages:

1. Interested bidders submit applications for shares along with their certificate(s) (see below) –one month.
2. Applications are processed, the share price is calculated, and winners are determined and informed about the auction results –one month.
3. The resulting shareholder lists are transferred to independent share registrars (for companies with more than 500 shareholders) and the issuer itself.

There are two types of certificate auctions in Ukraine:

- Certificate auctions for Privatization Property Certificates (PPCs). PPC auctions start on the 1st day of each month and last through that month – the first PPC auction took place in February 1995.
- Specialized certificate auctions for Compensation Certificates (CCs). CC auctions start on the 15th day of each month and end on the 14th of the next month – the first CC auction began on April 15, 1996.

Who conducts certificate auctions?

Certificate auctions are conducted by the Ukrainian Auction Center Network (UACN). The UACN was established in 1995 by the State Property Fund of Ukraine (the official seller of the Ukrainian State property) with technical and financial assistance from the U.S. Agency for International Development.

The UACN is headquartered in Kyiv at the Ukrainian Center for Certificate Auctions (UCCA). The UCCA collects data on all applications received at the Regional Centers for Certificate Auctions (RCCAs), which are housed in each of Ukraine’s regional capitals. The RCCAs, in turn, collect bids submitted at one of the 2,000 bid reception sites scattered throughout the regions. The UCCA is also responsible for auction calculation and distribution of results (via its regional network).

Who may participate in a certificate auction?

Participants in PPC auctions may include:

- Any citizen of Ukraine, who has not used his/her PPC before.
- Any financial intermediary (investment fund or company, trust company) with a license issued by the State Property Fund of Ukraine.

Participants in CC auctions may include:

- Any physical person (including foreigners).
- Any legal entity.

What types of applications for certificate auction participation exist?

There are two types of applications for participation in PPC auctions:

1. Type A application: an application stating the highest acceptable price for which the applicant agrees to buy shares.
2. Type B application: an application compiled with no price limitation, i.e., the applicant agrees to buy the enterprise's shares for any auction price, which will be formed during the auction.

Financial intermediaries can submit both type A and type B applications. Ukrainian citizens may submit applications of type B only. Auction participants may not withdraw their application once it has been accepted by the UACN. In CC auctions, only type B applications are accepted.

What is the "auction price" and how is it determined?

The total nominal (par) share value, which is the initial offering price for the shares, is determined based on a pre-auction asset valuation of the enterprise. The UCCA performs the calculation that leads to the auction price for which shares are eventually sold and determines the winning bidders separately for each enterprise offered for sale:

- The auction price is formed according to the balance between supply of/demand for shares by dividing total value of certificates bid by total amount of shares offered.
- The final auction price may be higher or less than the original nominal (par) value of the shares.
- Only an integer number of shares can be purchased for each certificate. If necessary, the rounding to the nearest smaller integer value is applied.
- If the ratio between the auction price of a share and value of certificate is such that more than 10% of PPC value (5% of CC value) is not covered by shares, a share split is performed. New (smaller) par value of shares is established and auction price is recalculated respectively.
- Winning applications get shares at actual auction price.

Who becomes the winner at a PPC auction?

The winners are all type B applications (with no price limitations) and only those of type A applications in which declared price limitation is higher than actual auction price.

Who becomes the winner at CC auctions?

All applications are winners because they have no price limitations.

Which documents confirm the auction results?

Results of the auction are represented in the following documents:

- An official protocol from the Auction Committee, approved by the State Property Fund, containing a nominal list of all auction winners and number of shares purchased by each of them. This protocol serves as grounds to enter the winners' names into a shareholder registry of the enterprise.
- Extracts from the above-mentioned protocol are issued separately to each winner, detailing the number of shares he/she has won.

Compensation Certificates

The history of compensating citizens' savings in the Saving Bank and the State Insurance Company lost during the hyperinflation following the collapse of the Soviet Union in 1991. A total of 4 Presidential Decrees, 2 Cabinet of Ministers (COM) Resolutions, and 2 Directives of the Supreme Rada (the Parliament) providing for the some measure of compensation have been issued. However, all the above attempts of the government to provide fair compensation have not been effective.

On November 24, 1995, a new approach to the compensation of savings was introduced by the Presidential Decree #698/94 "On the Compensation of Losses Incurred by the Citizens of Ukraine due to the Devaluation of Their Savings in the Saving Bank of Ukraine and the State Insurance Company of Ukraine". The Decree provides for the compensation in the form of a material privatization security named the "compensation certificate" (CC) which is freely tradable and used for the privatization of the state property.

Even though, the Supreme Rada has adopted the Law On Compensation of Citizens Savings, it does not look promising for Ukrainians as long as it provides for the compensation to be done far in the future. *Consequently, the compensation certificates are still the only real opportunity for Ukrainians to receive at least partial, but immediate compensation of their savings in the Saving Bank and the State Insurance Company.*

What is the compensation certificate?

Issued to compensate citizens savings at the Savings bank and former State Insurance Company of Ukraine (currently named Oranta) lost during the hyper-inflationary period in 1992, the certificates are freely tradable instruments utilized to purchase shares in medium- and large-scale joint stock companies being privatized as part of the mass privatization program.

Compensation is made in the following cases:

- Any amounts of any type of citizens deposits greater than 10 Ukrainian karbovansty (old Ukrainian currency) held on January 2, 1992, at the Savings Bank of Ukraine;
- Amounts of long-term insurance policies as of January 2, 1992, held at Oranta, the former State Insurance Company of Ukraine.

What is available in exchange for compensation certificates?

Per State Privatization Program for 1997, at least 70% of shares of open Joint Stock Companies (JSCs) created on the basis of group B objects, at least 50% of shares of open JSCs created on the basis of group C and at least 25% of shares of open JSCs created on the basis of group D shall be offered for sale with preservation of preferences for their employees and management envisaged by legislation, as well as at certificate auctions to citizens of Ukraine for privatization papers and compensation certificates. Unsold shares remaining from other forms of sale, such as closed subscription or privatization property certificate auctions, may also be made available for compensation certificate auctions.

Who has a right to receive certificates?

Any citizen of Ukraine who had remainders of deposits in Saving Bank of Ukraine or long-term insurance policy with State Insurance Company of Ukraine on January 2, 1992, or his/her heirs by legal testament, has a right to receive compensation certificates for the sum of compensation calculated in the manner outlined below.

Where are certificates picked up?

Compensation certificates are distributed by the establishments of the Savings Bank of Ukraine and the legal successors of Ukrainian State Insurance Company to the citizens of Ukraine in accordance with the Presidential Decree of Ukraine #698/94 from November 24, 1996 On the Compensation of

Losses Incurred by the Citizens of Ukraine due to the Devaluation of Their Savings in the Savings Bank of Ukraine and the State Insurance Company of Ukraine.

Citizens must pick up their certificates at the branch/affiliate of the Saving Bank of Ukraine or insurance company Oranta (State Insurance Company of Ukraine) where the citizen of Ukraine had the deposit or long-term insurance policy on January 2, 1992.

The amount of compensation is calculated by multiplying the remainder of all the deposits in the Savings Bank and amounts of long-term insurance policies held with State Insurance Company of Ukraine as of January 2, 1992, by 2,200 (the consumer price index increase in 1992-1993). The compensation amount shall then be rounded up to the nearest multiple of 1 million. Compensation certificates with a nominal value of one and two million Ukrainian karbovantsy are then issued for the calculated sum.

Official certificate distribution began on February 15, 1996.

What documents are needed to pick up the certificates?

The compensation certificates are available on the basis of documents certifying Ukrainian citizenship (namely: passport / temporary passport / military ID) or a will.

How can compensation certificates be used?

According to COM Resolution #161 from February 7, 1996, On the Procedure for the Circulation of Certificates Issued to Compensate the Losses Incurred by the Citizens of Ukraine due to the Devaluation of Their Savings in the Saving Bank of Ukraine and Former State Insurance Company and Presidential Decree from March 19, 1996, On Tasks and Peculiarities of State Property Privatization in 1996, compensation certificates are used for the purchase of shares of the joint stock companies created during the privatization process:

- *at specialized certificate auctions for compensation certificates through the auction center network* - by a physical or legal entity eligible for participation in privatization process according to article 8 of the Law of Ukraine On the Privatization of Property of State-Owned Enterprises. The first auction began on April 25, 1996, where 65 enterprises were offered for sale;
- *during preferential sales of shares as cash for half the value of the privatization property certificate* - by an employee of the enterprise or other physical entity eligible for participation in the preferential sales as established by Ukrainian legislation;
- *at auctions or tenders envisaged by the share allocation plan* - by a physical or legal entity eligible for participation in privatization process according to article 8 of the Law of Ukraine On Privatization of the Property of the State-Owned Enterprises;
- *during additional sales of JSC shares conducted after completion of preferential sales and sales at the PPC auction under conditions of abiding by the time-frame for the preferential sales pre-established by the share allocation plan* - by the management and deputy management of such enterprises, directors of the structural subdivisions of such enterprises, and chief specialists (if allowed by the management) at the nominal value for the total amount equaling up to 5% of the statutory capital.

COMMERCIAL AND NON-COMMERCIAL TENDERS FOR STATE SHARES

The two most important Ukrainian privatization laws were adopted in the spring of 1992. The Law of Ukraine “On privatization of small enterprises (small-scale privatization)” established the framework for the sale via tender of state-owned assets. The Law of Ukraine “On privatization of assets of state-owned enterprises” (i.e. large-scale privatization law) refers to the small-scale privatization law as the basis for conducting tenders for share packages of Joint Stock Companies (JSC) - i.e. medium/large enterprises - established in the process of privatization.

In 1992, the State Property Fund (SPF) developed and approved a Regulation according to the terms of which, until August 1997, both so-called “commercial” and “non-commercial” tenders for JSC shares were held. However, practical implementation of the regulation and the conducting of commercial and non-commercial tenders did not commence until early 1994.

Tenders are categorized as commercial or non-commercial depending upon the following general terms:

- Commercial Tender: A tender for the sale of a share package for which the winning party is the bidder offering the highest up-front, cash bid for shares - while assuming fixed future investment obligations in the enterprise. In a commercial tender, the competition is with regard to the up-front cash portion of the tender.
- Non-Commercial Tender: A tender for the sale of a share package for which the winning party is the bidder offering the largest future investment commitment - while assuming a fixed up-front cash payment for shares.

Both commercial and non-commercial tenders are held in two stages. In the first stage, the tender committee announces a preliminary winner and offers to other bidders the opportunity to improve their bids. In the second stage, a final winning bidder is selected. The SPF’s 1992 (Commercial and Non-Commercial) Tender Regulation did not establish a point system nor specific criteria for the evaluation of bids. This has of course made tenders - especially non-commercial ones - subject to insider “deals” and abuse by the privatization authorities and/or has invited undue pressures on those authorities by outside parties.

Winners of tenders have usually been represented by “buyers associations” established by enterprise directors and employees whose shares and future business plans are offered in the tenders, although such associations have in some cases been backed by either outside financial intermediaries or individuals. Until recently, the SPF conducted a large number of tenders for privatization certificates and compensation certificates. It was only in 1998 that the management of the SPF made a decision to conduct tenders exclusively for cash - with no use of PPCs or CCs.

Before 1995, i.e. before the initiation of the mass privatization program, there were no regulations governing the standardization of share allocation plans. The size of share packages offered for various means of sale (cash, certificates, business plans) was entirely in the hands of enterprise privatization committees and privatization officials. There were no established quotas as to what percentage of shares of each enterprise would be offered by what means. No quotas existed for privatization certificate share sales. Once these minimum quotas were introduced, the SPF for the first time had the opportunity to regulate the share allocation process and to influence decisions made by individual enterprise privatization committees. However, it was not until June 1997 that the SPF established some “guidelines” for the privatization committees as to the size of share packages to be offered for sale via tender and as to whether tenders would be conducted on a commercial or non-commercial basis.

In August 1997, the SPF finally adopted a new version of the Regulation “On the procedures for conducting tenders for the sale of share packages of open joint-stock companies established in the process of privatization”. In this document, for the first time there appears a provision requiring that at least 26% of a JSC’s statutory capital be offered in a commercial tender or, in exceptional cases for the largest enterprises, at least 15%. For non-commercial tenders, a share package of at least 51% of the JSC’s statutory fund is, as a rule, offered.

The inclusion of fixed or variable investment commitments in the commercial/non-commercial tenders process, combined with the fact that usually only a minority stake is offered for sale, raises a number of concerns about the effectiveness of this method of privatization. In 1996, the SPF made its first attempt to use Russia’s experience in attracting capital to enterprises via investment tenders. This appeared to represent a step forward compared to the previous primitive tender procedures. But experience seems to confirm that the new private owner knows better than the state how much, when and where to channel investments. Since very little information is made publicly available about companies when their shares are offered in tenders, requiring bidders to commit to future investment commitments - before they become owners and can determine what future investments are required - will not attract potential investors. Requiring investors who can acquire only 26% of shares in a tender - less than controlling interest - while requiring them to invest as through they are majority shareholders - is the greatest flaw in the SPF’s tender procedures. While in the past the SPF may have been lax as to whether promised investments are actually made, under pressure from prosecutors and the Parliament, the SPF is now required to ensure that investment commitments are actually fulfilled - otherwise the winning bidder is subject to losing his/her stake.

Combining up-front cash payments with future investment commitments in both commercial and non-commercial tenders has been utilized in both Russia and Ukraine as a means to meet both the state’s need for budget revenues and the enterprise’s need for investment capital. The attempt to combine contradicting interests in a single tender can lead to the satisfaction of neither. Fixed and complicated enterprise investment requirements, taxation of such transactions, the lack of opportunity for the investor to adjust the investment commitments according to changes in the enterprise’s and market conditions, the inability of the SPF to effectively monitor and control the fulfillment of future investment commitments - all of these factors serve to make the SPF’s commercial and non-commercial tender procedures less than effective even though it has generated some revenue for the budget.

In November 1996, the Parliament declared a moratorium on the use of tenders with investment obligations. The reason for this was that “buyers associations” (of enterprise directors and employees) became the winners of many investment tenders and did not fulfill their investment obligations per the sales agreements. One major example, a buyers’ association acquired a large share package of “Ternopil Oblenergo” (a major regional electric power distribution company) in 1995; the enterprise did not receive the investments as agreed with the winning bidder.

To get around the Parliament’s moratorium, the SPF implemented new procedures whereby “non-commercial/investment” tenders were replaced by “commercial/cash” tenders - with fixed investment obligations. Commercial/cash tenders continue to be announced almost daily which require that the winning bidder not only invest in plant and equipment but also replenish working capital, pay off accounts payable, repay short and long term debts, et al.

In compliance with the SPF’s August 1997 Tender Regulations, fixed (investment) requirements of commercial tenders are to be established by the tender committee for each enterprise according to recommendations of the privatization body (SPF or Regional SPF) and include an exhaustive list of

potential winning bidder future investment obligations including:

- * full or partial repayment or restructuring of outstanding accounts payable of the enterprise within 60 days of the signing of the purchase-sale agreement;
- * contributing cash - within 60 days of the signing of the purchase-sale agreement, in order to replenish working capital;
- * capital investment in the redevelopment of the enterprise's production equipment and the introduction of new production technologies;
- * retaining current and creating new employment over a certain period of time;
- * maintaining the existing business line, product range, and production volume of the enterprise existing at the time of signing of the purchase-sale agreement;
- * fulfillment of any "national security" tasks as defined by the state for the enterprise;
- * compliance with anti-monopoly legislation requirements;
- * improvement in working conditions for employees;
- * maintenance of social assets;
- * undertaking tasks to protect the environment, comply with environmental regulations or implementing environmental investments to correct any environmental damage by the enterprise.
- * privatization plans in commercial tenders involving a share package of more than 50% or a non-commercial tender are to be submitted in the form of a "business plan".

Enterprise privatization committees and SPF and SPF regional office officials, faced with the competing interests of cash for the budget versus investment in the enterprise, have generally opted to try to satisfy both parties - i.e., to require that the cash portion of the tender be set at a minimum of several times nominal value of the shares and that the investor be required to meet future investment obligations (as requested by the enterprise's directors and the branch ministries) in all of the possible investment categories listed above. This has contributed to the very low "success" rate of these tenders i.e. the low percentage of shares offered that are actually sold. Over the past six months, given the urgent requirements of the Government to generate budget revenues, the SPF has been under great pressure to resist the demands of enterprise directors and branch ministries - and to emphasize up-front cash over future investment commitments. Thus insuring that the tenders fail.

Tender Results

Results have been modest. During the September 1997 through May 1998 period - following the SPF's adoption of new tender regulations in August 1997 - 160 tenders were announced including 58 non-commercial tenders and 102 commercial tenders.

The non-commercial tenders announced during this 9 month period included: 54 share packages tendered for cash, 2 tendered for PPCs, 1 tendered for a combined means of payment (PPCs and cash); and 1 tendered for CCs.

The percentage of statutory capital offered in tenders during this period varied. In Commercial Tenders, the range was between 10% and 57% of statutory capital, with an average of 29%. In Non-Commercial Tenders, between 15% and 75% of the shares were offered, with an average of 37%.

Out of the 160 tenders announced: for 101 no information was published on the results of sale (although this is required by privatization legislation); 11 tenders were officially announced as successful. This implies that 149 tenders were unsuccessful. But of these only 23 enterprises were offered a second time with share packages re-offered at a reduced starting/floor price and/or with reductions in future investments required.

Of the 11 officially sold share packages, 5 were sold via commercial tenders for cash. The total nominal value of shares sold was UAH 14,238,057. For these 5 share packages, the SPF initially asked (the initial/starting price) UAH 20,525,310 or 144% of the nominal value but UAH 21,132,100 UAH was actually received in the form of cash - or 103% of the starting price, 6 were sold via non-commercial tenders. The total nominal value of shares sold was UAH 3,894,999. UAH 32,913,024 was reported as actually received by the SPF.

It is important to note that, while these are the only official results - as published (as required) in the Investment Gazette - there have been other enterprises for which large share packages were sold via commercial and non-commercial tender. The problem is that the results (if any) remain opaque.

TENDERS FOR INTERNATIONAL ADVISORS TO SELL STATE SHARES TO STRATEGIC INVESTORS

In the fall of 1997, President Kuchma issued the Decree “On Conducting International Sales (Tenders)”. To implement the Decree, the State Property Fund (SPF) hastily developed (with little or no donor-supported technical assistance) and approved the “Regulation on the Selection of the Authorized Person (Advisor)” and the “Regulation on International Sales (Tenders)”. The regulations provided for the tendering for the selection of advisors who would in turn conduct international tenders for the sale of state share packages in Ukraine’s 25 to 50 most attractive enterprises. The signing of the Decree was prompted by the urgent need of the Government to generate privatization revenues for the state budget.

Some Cabinet of Ministers, Presidential Administration and SPF officials attempted to follow Russia’s example of arranging quick “loans for shares” transactions whereby international banks would be provided with state shares as collateral for bank loans - with the loans to be repaid through the sale of the state shares (which did not occur, leaving the banks with attractive shares “purchased” on an uncompetitive basis).

Ukrainian privatization legislation does not allow for the use of a “loans for shares” scheme as was done in Russia. Thus, in order to quickly generate cash for the budget, these GOU officials encouraged the SPF to include in its the Regulation on Advisors, the provision which stipulates that the advisor is to provide bridge financing to the Government.

Tender advisors under the December 1997 (currently operative) regulation are to provide up-front, bridge financing in exchange for future success fees for arranging the sale of share packages to strategic investors (the proceeds of which are to be used to repay the bridge financing). The GOU officials believed that hundreds of millions of dollars in financing could be generated by hiring advisors to arrange financing/conduct tenders for the sale of strategic enterprise share packages.

The Parliament rejected the Presidential Decree on international tenders and in February of 1998 adopted the Law on the 1998 State Privatization Program which provides for “open sales (tenders)” of strategic enterprise share packages. Thus the President’s proposed “international sales (tenders)” became “open sales (tenders)”.

There are several key features which distinguish the current “open sales (tenders)” regulations adopted in December 1997 (and the newly drafted, revised “open sales (tenders)” regulations from the existing commercial and non-commercial tender regulations which were originally adopted by the SPF in 1992, have been in use since 1994, and were revised in August 1997:

- * Open sales (tenders) are to be used for an enterprise for which a share package of more than 25% is to be tendered, which is a Group C or D (large-scale) enterprise, whose sales exceeded UAH 100 million in the previous fiscal year and whose book value of fixed assets is more than UAH 100 million. The concept is that only enterprises of the greatest potential attractiveness to international (and domestic) investors will participate in such tenders.
- * The State Property Fund (SPF) is required to tender for an advisor to conduct each tender.
- * The share package tender is to be conducted in one round (versus commercial and non-commercial tenders which are conducted in two rounds, with winners from the first round required to submit new bids in the second round).

Given the drawbacks of the December 1997 regulations, in particular the requirement that the winner of the advisor tender arrange bridge financing, the GOU and the SPF came under increasing pressure from the international donors in early 1998 to revise the December regulations.

Also under pressure from Vice Prime Minister Tyhypko to meet World Bank conditionalities for international advisor/tender regulations which would be more transparent and internationally acceptable than the December 1997 regulations, the SPF began to work more seriously with USAID and TACIS-funded international consultants to draft new regulations to govern the tendering for international advisors to conduct sales of large share packages in Ukraine's largest, most attractive, strategic (and privatizable) enterprises.

The joint SPF/donors' consultants working group reviewed the existing tender regulations, obtained third party (international investment bank, investor) "best practices" input, and drafted changes for new international advisor and share tender regulations. The tender working group sought to increase the transparency of the tender process, introduce internationally accepted tender procedures, and introduce proposal evaluation procedures understandable and acceptable to potential international investors.

In June 1998, the SPF adopted and submitted to the Ministry of Justice for approval the new, donor supported, international advisor tender regulation and the related tender regulation. Unfortunately, officials in the Cabinet of Ministers sought to re-introduce the bridge financing proposal and the Securities Commission objected to the clause allowing for international donor-funded advisors (selected on a competitive basis by the donors) to serve as advisors. Thus, the first draft of the advisor regulation submitted by the SPF in early June was returned by the Ministry of Justice.

The SPF, with donor consultant assistance, was able however to convince Cabinet of Ministers' officials and the Securities Commission to avoid inclusion of the bridge financing proposal and to retain the donor-funded advisors clause. As a result, on July 2, 1998, the heads of the SPF, Securities Commission and the Anti-Monopoly Commission (the latter two agencies are required to sign-off on all major regulations adopted by the SPF) signed both the advisors and tender regulations which were registered by the Ministry of Justice on July 3..

Key elements of the regulation on tendering for international advisors include the following:

- * Pre-qualification criteria for advisors are included related to both financial status and relevant experience in conducting international tenders.
- * A clear-cut procedure has been established for submitting bids and confidentiality agreements.
- * The provision on bridge financing has been removed from the regulation. Winning bidders are however required to provide a nominal "performance guarantee" deposit to ensure that the winners do not fail to comply with the terms of their proposals.
- * Enterprise information seminars for bidders are to be conducted by the SPF.
- * Bidders are to submit sealed envelopes containing technical and financial proposals and supporting documents.
- * Technical and financial proposals are to be evaluated separately by the evaluation committee.
- * Evaluations are to be point-based with the bidder receiving the highest score declared the winner.

Among the tasks which the SPF may require the advisor to undertake are the following: Valuation of the share package to be offered for sale. Conducting an information and advertising campaign. Compiling the information memorandum. Developing the tender documentation. Contacting and seeking to attract potential investors. Organizing the conducting of the tender. Providing assistance to the SPF in negotiations with the winning bidder.

To date, the SPF has conducted two tenders to select international advisors for the sale of strategic enterprise share packages. The advisors are to conduct the sale via tender of large share packages in Donbasenergo and Tsentrenergo, two electric power generating companies. The tenders to select the two advisors were conducted according to the December 1997 (“bridge financing”) tender advisor tender regulation.

As expected, the SPF has been negotiating for many weeks to conclude contracts with the winning advisors - with the stumbling block being the size and nature of bridge financing to be arranged by the advisors. The Ministry of Finance has rejected the financing terms of the winners due to the interest rates demanded and the advisory agreements remain unsigned.

CONTRACTS FOR THE MANAGEMENT OF STATE OWNED SHARES

Prior to the initiation of privatization of an enterprise, the relevant branch ministry is responsible for managing the enterprise/the state-owned property. The State Property Fund (SPF) is invested with the authority/responsibility to manage state property during the privatization process. Although the SPF reports to the Parliament, the Cabinet of Ministers is invested with the ultimate authority/responsibility to represent the state's ownership interests.

After a decision has been made to undertake the steps necessary to privatize an enterprise, the rights to manage the property are transferred to the State Property Fund (SPF), the sole government agency with the authority to manage and sell state property. As the manager of the enterprise, the SPF concludes a contract with the enterprise director authorizing him to continue managing the enterprise - under SPF responsibility - while its privatization is being initiated.

When the Cabinet of Ministers takes a decision for the state to retain a share package of an enterprise undergoing privatization, the SPF is responsible for the management of these and other unsold state shares. At present, 70% of all state share packages are managed by the SPF. The SPF generally authorizes an SPF official to represent the interests of the SPF/the state at the general shareholder meetings.

The Cabinet of Ministers has the right to decide to transfer management control of state shares from the SPF to other bodies. There are three options available to the Cabinet:

- 1) Appoint a government body (usually a branch ministry) and one of its officials as the authorized person to manage state shares, e.g. the Ministry of Energy manages state holdings in the energy sector. 30% of all state packages are managed by branch ministries.
- 2) Conduct a tender for a non-state (private sector) authorized person to manage the state's share package in a particular enterprise. The winner receives an "authorization contract" from the SPF. Directors of the enterprise in question can not participate in the tender. The winner of the tender must pay an up-front deposit of 10% of the book value of the share package; must have a "certificate" from an appropriate training authority confirming that he is "trained" to serve as a manager in the particular industry; will receive any fee and the return of his deposit only in case the SPF acknowledges his management as "satisfactory", etc. The authorized person is obliged to fulfill an extensive list of tasks which often can not be executed given the shareholding power of the package being managed. These conditions make it difficult even for insiders to get management control of state shares.

The SPF approved the regulation on the tender for authorized persons to manage state shares only in December 1997. No such tender as ever been successfully concluded.

- 3) Include the right or option to manage state shares as part of the terms of a commercial or non-commercial tender. The strategic investor – the winner of the tender – thus obtains management control rights without having to conduct a separate tender to manage state shares. This third option is incorporated in the 1998 Privatization Program and has been included in recent tenders for energy distribution company shares. Unfortunately, a new draft Law on Management of State Property, which was passed by the Verkhovna Rada in the its first reading earlier this year, does not provide for such an option.

Although this third option is most acceptable for investors (outside of the outright sale of all state

shares), this option for management of state shares also has problems: the standard management contract which is supposed to be signed with the investor requires the investor to assume numerous and excessive responsibilities giving the investor little decision-making leeway. The tasks required of the authorized person/investor are proposed by the relevant branch ministry and generally include requirements which the branch ministry itself has been unable to fulfill (e.g. payment of unpaid wages, maintenance of employment, maintenance of the enterprise's main lines of production).

In sum:

- _ The SPF manages 70% of state owned share packages.
- _ Branch ministries manage 30% of state owned share packages.
- _ No contracts have yet to be signed with third parties/winners of commercial and non-commercial tenders to manage state shares.
- _ The SPF and the Cabinet of Ministers need to draft a new, standard management contract which is more attractive to potential investors.

PRIVATIZATION VIA STOCK EXCHANGES AND THE OTC MARKET

Through June 1998, the State Property Fund (SPF) has been offering state shares on Ukraine's four established stock exchanges, the Ukraine Stock Exchange in Kyiv, the Donetsk Stock Exchange, the Kyiv International Stock Exchange, the Ukraine Interbank Currency Exchange and their regional branches and via the "PFTS" which is Ukraine's electronic trading/OTC market. The Ukraine Stock Exchange (one of four exchanges licensed to trade on the secondary market) is Ukraine's first stock exchange, having begun operations in 1992, and conducts auctions for small privatization packages. The PFTS is a member-owned, association of broker-dealers which operates a decentralized, quote-driven, OTC trading system.

Until October 1997, the SPF primarily utilized local stock exchanges for the sale of small, leftover state share packages of essentially privatized enterprises, the vast majority of share packages having been sold for privatization certificates. Under growing pressure from the Government to begin generating more revenues for the state budget in the fall of 1997, the SPF began an accelerated program to offer shares on stock exchanges, rapidly increasing the number and size of offerings - while reducing the size and number of share packages offered in certificate auctions. In December 1997, the SPF began offering share packages via the OTC market.

The role of the stock exchanges increased in importance with the offerings of Ukraine's regional electric power distribution companies beginning in October of last year..

The procedures for privatizing enterprises through the stock exchanges were approved by the SPF in 1992 with subsequent amendments to procedures. These procedures clearly state that bidders may be individuals or companies, are not required to have a license (except for PFTS bids) and only the highest bidder wins a given share package. The starting price for enterprise shares is the nominal value of one share according to the enterprise's valuation.

Previously, the SPF was permitted to decrease the starting price if there were no bids, but it could not go below nominal value. Beginning this year, the SPF has the authority to offer packages for sale at below nominal value, at the market price. The SPF's stock exchange sales department has, however avoided reducing prices below 30% of nominal value. In practice, the SPF will offer a share package for sale via stock exchanges no more than five times. If, after five unsuccessful attempts to sell the shares, there are still no bidders (despite lower starting prices), the SPF will return the share allocation plan to the regional SPF office for revision and will sell the shares via other means.

Lately, with increasing pressure being placed on the SPF to generate revenue for the state budget, the stock market has become more active as a sales vehicle and has featured more attractive enterprises. For example, nearly all of the state-owned power distribution enterprises include in their share allocation plans a percentage of shares to be sold via stock exchanges. In addition, the share allocation plans of some of Ukraine's most attractive grain elevators and bread-producing enterprises have recently been amended to include a percentage of shares for sale via the stock market.

From January through mid-June 1998, the SPF offered via stock exchanges 891 share packages worth UAH 285.4 million nominal/book value. For 547 of these share packages worth UAH 216.7 million in nominal value (63% of the total number of packages and 24% of the total nominal value of offered shares), the SPF received no bids, despite the SPF's discounting of starting prices by up to 30% under the nominal value.

344 share packages generated some interest and were partially or fully sold. These packages brought UAH 111.9 million in privatization revenues to the SPF for the first 5 ½ months of 1998. While the revenues generated for the state budget are significant, it is apparent that too many unattractive companies are offering shares which cannot be sold via the stock market at prices at or close to nominal value. The SPF must either offer these shares via the secondary market at a market determined price or sell them in certificate auctions.

The SPF is planning to offer 371 share packages via stock exchanges/the OTC market in late June and early July. This will bring to 1300 the total number of share packages offered via stock exchanges of which more than 800 are unlikely to be fully sold.

The effectiveness of the OTC market versus share offerings via stock exchanges is quite apparent. While only 8 electric power distribution company share packages have been offered to date on the OTC/PFTS (less than 1% of the total number of electric distribution company share packages offered via the secondary market), UAH 26.6 million in revenues were generated from these sales via the OTC market - *or 24% of the total revenues generated from SPF share sales via stock exchanges.*

Over the past nine weeks, stock exchange sales have generated 40.4 % (UAH 27.8 million) of the total privatization revenues for this period.

While stock exchanges are proving to be a significant source of privatization revenues, the Government has not achieved the results it had hoped for with stock exchange sales. In fact, the number of share packages sold each month and the depth of share sales is declining. Our estimation is that roughly 200 enterprises per month would reach 70% sold if all share packages offered on stock exchanges were sold. However, recent trends and market conditions indicate that only 10% of this number (20 enterprises per month) will be privatized via stock exchange sales through the end of 1998, assuming the shares are offered at or close to nominal value. To take one recent example, on May 26, 1998, there was not a single bid for any of the 70 enterprises offered for sale via the Ukraine Stock Exchange.

There are several reasons for these disappointing results. Firstly, there are no defined procedures for determining which enterprises should be sold via stock exchanges, which via tender, which via certificate auctions, etc. As a result, the SPF will often attempt to sell shares of enterprises using a mechanism which is inappropriate for the enterprise's size, share package, and/or sales price. Secondly, the SPF tends to offer small share packages (less than 26%) on the stock exchanges which are not attractive to potential strategic investors. Finally, the Government continues to hope that investors will agree to buy shares at prices higher than nominal value. If, instead, the State Property Fund simply sold *at nominal value* only those share packages of 200 largest and most attractive enterprises which have already been approved for cash sales, it could generate an estimated UAH 1.3 billion (exceeding the 1998 privatization budget revenue target of UAH 1.04 billion).

“MASS CASH” AUCTIONS

Outside of the generally unsuccessful cash share offerings via local stock exchanges and commercial/cash tenders described elsewhere (in which shares have been offered at or close to nominal/book value), the State Property Fund (SPF) developed regulations and procedures in the spring of 1998 to begin “mass cash” share sales via the Auction Center Network (ACN) beginning in July 1998.

Cash Auctions via the Auction Center Network

The “mass cash” share sales program has the following attributes - as proposed by the SPF - versus cash sales via the OTC market and stock exchanges:

- * *State Property Fund strategy for mass cash share packages:* Share packages of unattractive enterprises (for which the enterprise director or employees might be the only bidders) and small packages of leftovers of any quality (following other forms of share sales) will be offered in mass cash auctions via the ACN. The SPF’s strategy for OTC/stock exchange sales is to offer more attractive enterprises (i.e. the SPF is not offering the hundreds of packages of leftovers of unattractive enterprises via the OTC/stock exchanges).
- * *Share packages:* Only the entire share package offered in mass cash auctions via the ACN will be sold (i.e. packages cannot be split and sold in smaller lots as is the case via the OTC and stock exchanges).
- * *Minimum bid:* The minimum bid for each share package offered via the ACN will be UAH 10 (the minimum bid on the OTC and stock exchanges is the starting price). As is generally the case with the OTC and stock exchanges, the starting price via the ACN will be nominal value. The difference is that via the ACN, the nominal value/starting price means nothing - each package can be sold for as little as UAH 10.
- * *Number of winning bidders:* All mass cash bidders will receive shares (versus the OTC/stock exchanges where there is only one winning bidder per lot).
- * *Selling price:* The mass cash selling price per package will be the total value of all bids submitted divided by the number of shares offered (versus the highest single offer for the lot via the OTC and stock exchanges).
- * *Who can bid:* Any individual or legal entity can bid directly in mass cash auctions (versus broker dealer members on the OTC).
- * *Depth of sale:* 100% (if one bid) in mass cash auctions (versus much less than 100% is possible via the OTC/stock exchanges).

Effectiveness of Cash Auctions via the Auction Center Network (versus other sales vehicles)

The first “mass cash” auction has yet to be conducted. The proposed conditions for conducting such auctions provide for a differentiation with OTC and stock exchange sales and could allow for the rapid sale of “leftover” share packages at prices far below book value.

The SPF’s declared strategy is to complete the 100% privatization of more than 5000 enterprises in which the state retains small shareholdings, to generate additional revenues for the state budget (the plan is to generate 2% of the 1998 privatization revenue target or UAH 24 million), and to provide an opportunity for the general public to participate in cash privatization.

However, analysis of the 102 enterprise share packages to be offered in the first mass cash auction in July indicates that the SPF may well fall short of its objectives. 79 of these 102 enterprises are

medium-large enterprises. 52 are agro-industrial. The average size of share package being offered is 11% of total capital.

Investor interest will be directed to only six enterprises which received significant investor interest in earlier privatization certificate auctions. If so, the SPF can expect to generate only UAH 3 - 3.5 million in revenues from the first auction. Shares of the six attractive enterprises are being offered in the pilot auction in order to attract potential investor interest in future cash auctions. These six enterprises are in the relatively attractive electric power, baking, chemical and wood processing industries and share packages being offered are from 4% to 27% of each enterprise's total capital.

If these relatively attractive share packages were offered for sale via stock exchanges/the OTC market, the SPF would be able to generate revenues within one day. Any revenues generated via cash sales through the ACN are not available until 30 days after the initiation of the sale.

In terms of the potential for participation by individuals in the first mass cash auction, an analysis was conducted as to the participation of individuals in earlier Privatization Certificate (PPC) and Compensation Certificate (CC) auctions for shares of the enterprises participating in the first mass cash auction. 74% to 85% of all certificates were invested in these enterprises by financial intermediaries. Thus, it is clear that interest by individuals in buying the shares of these enterprises is very low. They are unlikely to invest cash when they did not invest "paper". At the same time, sales via stock exchanges and the OTC represent a much more efficient and less expensive mechanism to sell shares to financial intermediaries.

Mass cash auctions via the Auction Center Network might only be an effective privatization tool if the following guidelines are applied. Offer at least 700 to 800 share packages of only unattractive enterprises per auction to include enterprises which meet three criteria: they have been unable to sell shares at below nominal value on stock exchanges/the OTC market, they have fulfilled their certificate share sales quotas required by the 1998 Privatization Program, and they could reach 100% sold if their mass cash share packages were sold.

Regional Cash Auctions

In addition to cash auctions via the Auction Center Network, the SPF is planning to conduct local "dutch" cash auctions - via local agents - using an "open outcry" system. Such auctions would be conducted for the sale of leftover shares in enterprises deemed by the SPF to be of interest to only local residents (e.g. employees/managers/and their relatives).

The SPF proposes to appoint local agents (any legal entity, local stock exchange, local auction center) who would auction shares of smaller medium/large enterprises. Share packages could be split into smaller lots. While the SPF proposes a floor price per lot of nominal value less 10%, the SPF's advisors propose no floor price.

Any individual or legal entity may bid. Shares will be delivered within 5 days of the auction. The auction will be concluded within a matter of minutes.

Versus the mass cash auction scheme (where auctions will be conducted over a period of two weeks on an expensive, nationwide basis), the dutch auction scheme is a less expensive, more efficient mechanism which could substitute for the mass cash program.

GOU Cash Generation Strategy

One of the major strategic mistakes being made by the GOU/SPF concerns the notion that hundreds or thousands of enterprises need to be sold for cash in order to raise the required (by the 1998 Privatization Program) UAH 1+ billion in privatization revenues before the end of the year. The danger in this assumption is that quantitative privatization targets (9,500 privatized by the fall of 1998) will not be met, while qualitative targets (UAH 1 billion revenues) will also be difficult to meet - given the ineffectiveness of cash privatization thus far and the low quality of the enterprises being offered for cash sales.

- The SPF can focus its efforts on a small number of enterprises which could be sold for cash this year and generate the needed UAH 1 billion. The rest of the enterprises should be sold primarily through mass privatization means – preferential sales, free transfers, and certificate auctions.
- A short list of enterprises, which are in the share sales process, which have unsold shares allocated (via *approved* share allocation plans) for cash sales, and which together would raise UAH 1.3 billion (with 80% of proceeds going directly to the budget), if they sold the full allocation for cash at *nominal value* - has been prepared.
- The list includes enterprises which:
 - * have begun share sales – i.e., have approved share allocation plans;
 - * have cash sales (tenders, stock exchange sales, cash auctions) included in their share allocation plans;
 - * have the highest book value of shares allocated for cash;
 - * and for which no additional approvals, compromises, or deals are needed to conduct these sales. Share allocation plans have been approved and sales may thus be conducted by the SPF without further delay.

PRIVATIZATION AND DEMONOPOLIZATION OF THE AGRO-INDUSTRIAL COMPLEX

Summary

The grain sector is one of the most important sectors in Ukraine's economy. Approximately one-half of the universe of medium and large enterprises of the mass privatization program (5,000 of 10,000) are "agro-industrial complex" (AIC) enterprises. Of the 5000 AIC enterprises, 4000 have begun share sales - of which 3500 have sold more than 70% of their shares.

With the passage in 1996 of the "Law on Peculiarities of the Privatization of the Agro-Industrial Complex," the privatization process for AIC enterprises changed. Although in general the privatization principles are similar to those for industrial enterprises, certain significant differences appeared.

From 1996, non-farm agro-industrial (i.e. agricultural commodities processing, storage and distribution) enterprises require a more complex and time-consuming privatization process. Privatization of each enterprise is initiated by the State Property Fund or by a potential buyer (if any potential investor proposes to buy an enterprise, the privatization of the enterprise is required to be initiated).

The next step is for the SPF, Cabinet of Ministers and Ministry of AIC to agree on the enterprise's share allocation plan. This step may take from two weeks to several months, depending on the size of the enterprise and the inclusion of a state shareholding. Following approval of the share allocation plan and the registration of the share issue, the share sales process begins.

During the first step of share sales, 51% of the enterprise's shares are distributed free of charge to up to dozens (for the largest AIC enterprises) of agricultural suppliers (i.e. collective/cooperative farms), each of which concludes a separate contract with the State Property Fund on the transfer of ownership of the shares allocated to the supplier. According to the 1996 Law, this process may take up to four months.

Next, employees and management are given an opportunity to purchase shares on preferential terms. The percentage of shares allocated to employees and management depends on the size of the enterprise and can vary from 5% - 40%, although on average this share allocation is 30%. The process of preferential share sales (for certificates) to employees is allowed to take up to one year.

If unsold shares remain after the first two steps, they may be sold in certificate auctions (for PPC's and/or CC's) or cash (via stock exchanges, mass cash auctions, local dutch auctions and/or tenders).

The state may retain shares in "strategic" enterprises - including AIC enterprises - for up to five years. Recent share allocation plans for Ukraine's most attractive grain elevators, for example, include a 25%+one share holding reserved for the state.

For the largest AIC enterprises, share allocation plans generally include an allocation for stock exchange sales and/or tenders. If such allocations are included in the share allocation plan, these cash sales are conducted in parallel with free transfer to suppliers and preferential sales to employees.

The Universe of Grain Processing Enterprises Subject to Privatization

■ Grain processing enterprises: number and type

The grain processing industry is a network of enterprises engaged in grain procurement, storage, distribution and the production of bread and bread products. Enterprises include grain elevators, grain sales bases, mixed fodder plants, flour mills, bakeries etc.

The state-owned enterprises of the grain processing industry are governed by the Ministry of Agro-Industrial Complex (AIC). The Ministry of AIC delegated control over 543 enterprises to a quasi-governmental organization called «Khib Ukrainy».

■ Khib Ukrainy and the grain processing industry

Khib Ukrainy (KU) is the legal successor to the Ministry of AIC's grain management agency and was created by Cabinet of Ministers Decree No. 1000 and registered as a state joint stock company («DAK») in August 1996. KU expected to receive all or a portion of the assets of 543 grain processing enterprises to serve as the charter capital of Khib Ukrainy. To date, up to 100% of the assets of 83 KU enterprises have been transferred to the company's charter capital.

The most recent changes to the structure and status of KU were made on November 5, 1997, by Cabinet of Ministers' Resolution No.1218. According to this Resolution, 100 enterprises — including some of the most attractive grain processing and procurement enterprises in the country — must transfer their property to the charter capital of Khib Ukrainy and be converted into daughter companies. These 100 comprise Annex No. 3 to CabMin Decree No. 1218 and are commonly referred to collectively as «Khib Ukrainy.»

13 of the 100 have already begun the privatization process, thereby putting their status as «Khib Ukrainy» enterprises into question. The Cabinet of Ministers is currently discussing the question whether to remove them from Annex No. 3, transfer a percentage of their shares to KU or undo their privatization and transfer them entirely to Khib Ukrainy.

■ Status of privatization of the grain processing industry

According to our data, the total number of grain processing facilities in the grain processing industry is 1272. Of these, 26 enterprises are veterinary sanitary plants prohibited from being privatized by Cabinet of Ministers Decree No. 88 (1995). In addition, 100 enterprises are scheduled to be transferred to Khib Ukrainy and at present are not subject to privatization. A further 330 enterprises are fodder plants which are generally jointly owned by several collective farms and have few if any state shareholdings. Thus, the total number of grain processing enterprises that may be privatized is 920.

Some of these 920 enterprises (mainly elevators) have subdivisions which store state mobilization reserves. These subdivisions are prohibited from privatization. Often they can not be physically separated from non-state grain, thereby making the privatization of the enterprise's property practically impossible.

The publication of CabMin Decree No. 1218 has been the most important event to date in the demonopolization and privatization of Ukraine's grain processing industry. It superseded Cabinet of

Ministers Decree No. 1000 and jump-started the privatization process. CabMin Decree No. 1218 called for the privatization plans of 100 enterprises to be approved by December 31, 1997 and for the privatization plans of an additional 343 enterprises to be approved by July 1, 1998. The Decree also recommends that the State Property Fund sell for cash any shares remaining after the completion of preferential sales to suppliers and employees. Finally, the Decree lists the 100 and 343 enterprises — including elevators, grain procurement enterprises, and bread manufacturers — by name and by oblast.

In late December 1997, the Cabinet of Ministers released two documents (Protocol No. 42 and Protocol No. 43) announcing that the privatization plans for 99 enterprises from Annex No. 1 had been approved. These documents represent a significant step forward in the privatization process. It is important to keep in mind, however, that each enterprise must now have its share allocation plan approved individually by the Regional Property Fund and/or State Property Fund. To date, 365 enterprises have had their privatization plans approved.

In addition to the 443 grain processing enterprises listed by name in CabMin Decree No. 1218, an additional 477 enterprises are privatized or eligible for privatization. These include grain procurement enterprises, feed mills, collective farm feed facilities (if they include a state share), and bakeries. These enterprises are being privatized according to the same procedures as all other eligible non-agricultural processing enterprises (including grain elevators) and in full accordance with relevant privatization legislation.

■ Leased enterprises

A significant number of grain elevators and other grain storage facilities (about 100 enterprises total) are leased enterprises. Many of these lease agreements will expire in 1998. Leased organizations may own from 15% to 80% (but, typically, from 40% to 60%) of the enterprise's property. This property is already private and is excluded from the process of privatization. When such an enterprise is converted into a joint stock company, the shares are transferred to the members of the leased organizations.

■ Enterprises of particular interest to investors

Private investors, domestic and foreign, will most likely be interested in the following enterprises:

- large grain complexes («combinats»), which as a rule include the complete technological complex of a grain elevator, grain procurement and grain processing facilities, including mills, mixed fodder production, etc. (95 privatizable);
- grain elevators, especially those «strategically» located near transport junctions, sea ports, etc. (72 privatizable),
- grain procurement enterprises and grain sale bases.

These three groups of objects are referred to collectively as «grain elevators».

Key players in the privatization process

■ Ministry of the Agro-Industrial Complex

The Ministry of AIC is the executive body subordinated to the CabMin and assigned to manage the property of state-owned grain industry enterprises. It may initiate and carry out the corporatization of enterprises. In the process of privatization, the Ministry of AIC agrees upon the privatization (and share allocation) plans of enterprises drafted by the State Property Fund,

which is a necessary condition for their approval by Cabinet of Ministers. Thus the Ministry has significant influence over share allocation.

■ **State Property Fund / Regional Property Funds**

The State Property Fund (SPF) is the Government's privatization body, responsible for managing the privatization of Ukraine's largest and most attractive enterprises. The Regional Property Funds (RPFs) are regional branches of the SPF and are responsible for privatizing enterprises in the regions. Responsibilities for both entities include: initiating privatization; drafting privatization plans and share allocation plans; negotiating approval of these plans with other Government agencies; implementing privatization plans; and conducting preferential and other kinds of share sales.

■ **Khlib Ukrainy**

Khlib Ukrainy may take part in or (if the Ministry of AIC concurs) delegate its representatives to SPF and RPF privatization commissions; in practice, KU wields significant influence over the grain processing enterprises at a local and national level.

■ **Cabinet of Ministers**

Approves privatization plans (including share allocation plans) of all grain industry enterprises with special attention paid to the size of the state share.

■ **Verkhovna Rada (the Parliament)**

The Verkhovna Rada approves new laws and changes to existing laws. It is thus able to change the legislative environment, privatization procedures or even prohibit elevators from privatization. But it does not play any role in the practical implementation of established procedures.

The Legal Framework for Privatization of the Grain Industry

- Law on Privatization of Property of State-Owned Enterprises (February 19, 1997). The Law establishes the general principles of privatization, such as the right of employees of an enterprise to obtain shares in exchange for their privatization property certificates. The Law also defines the various methods of privatization and share sales. In addition, the Law determines who has the right to buy state property and defines the rights of non-resident buyers.
- Privatization Program: Privatization Program for 1998. The Program determines specific requirements, tasks, methods of privatization, payment means, etc. which will be employed during the current year.
- Law on Peculiarities of AIC Privatization (July 10, 1995): This Law establishes different schemes for the privatization of two major groups of AIC enterprises - «agricultural» producing enterprises and «non-agricultural» processing enterprises (i.e. AIC enterprises which do not produce agricultural products, including grain, but are involved in grain handling, storage, processing, etc.). Grain elevators belong to the second category. Unfortunately, many basic clauses of the Law contradict each other and make implementation very difficult. For example, articles 3 and 25 require share packages to be allocated for the state, employees and suppliers. The sum of these allocations often exceeds 100%.
- Cabinet of Ministers Resolution No.1000 (August 22, 1996) on the creation of Khlib Ukrainy.
- Cabinet of Ministers Resolution No.1218 (November 5, 1997) on the demonopolization of Khlib Ukrainy and privatization of major part (443) enterprises.

- Cabinet of Ministers Protocol Decisions Nos. 42, 43 (December 1997): approved share allocation plans of grain elevators being privatized and introduced a requirement to sell state shares in AIC companies for cash through the Stock Exchange and commercial tenders.
- SPF Regulation No. 803 (September 1, 1997): a detailed procedure for the privatization of non-agricultural processing enterprises (grain elevators). Provides a compromise interpretation of the Law on peculiarities of AIC privatization.
- Standard Privatization Plan for non-agricultural AIC enterprises, SPF Orders, Instruction Letters etc. - these standard implementation documents are approved and issued by the SPF.

Current Privatization Procedures for Grain Elevators

The privatization procedure for grain elevators - as non-agricultural processing AIC enterprises - consists of the following steps.

- *Initiation of privatization*
The SPF or Regional Property Fund (RPF) initiates privatization, depending on which of these bodies monitors the privatization of the enterprise. In addition, a buyer or employees' association may submit an application to the SPF to initiate privatization.
Important note: even if an elevator is scheduled to transfer its assets to KU, a potential buyer may still initiate the privatization process by submitting a bid to the SPF. The SPF has no legal grounds to reject the application unless the elevator is prohibited from privatization by law.
- *Privatization body approves decision on privatization*
The decision must be made no more than one month after privatization is initiated.
- *Privatization commission is created*
The commission includes Ministry of AIC and KU representatives, the enterprise director and chief accountant, SPF representatives, etc. The commission is to be created no more than one month after the decision on privatization is approved.
- *Compiling the list of suppliers*
For each non-agricultural AIC enterprise being privatized, a list of agricultural suppliers (for processing enterprises) or service consumers (for servicing enterprises) is compiled by a privatization commission on the basis of an appropriate certificate issued by the local administration body governing AIC. Suppliers are included if they can prove that they have a contract with the enterprise. Compiling the list and gaining its approval may take up to 20 days.
- *Asset valuation (see below)*
- *Drafting the Privatization Plan and Share Allocation Plan*
The share allocation plan is divided into two major sections: 51% of shares to be transferred to suppliers and 49% to be distributed via other means. The 51% is divided into quotas, one quota for each supplier on the list. The shares for each supplier are determined on the basis of its average annual volume of supply during the last five years. If an enterprise does not have direct suppliers, some agricultural producing companies can be included into the share allocation plan on the recommendation of an enterprise or the local administration body governing AIC. In this case, the total percentage of shares for suppliers can comprise less than 51%.

The remaining 49% is allocated as follows:

- shares reserved for preferential sale to elevator employees. The number of shares is determined by the number of employees, who can invest 1 PPC and the equivalent of 0.5 PPC in cash or compensation certificates;

- 5% for management for PPCs
- 5% for management for CCs
- shares for open sale at certificate and specialized auctions (leftovers)

The enterprise's privatization plan is submitted by the privatization commission to the SPF or RPF no more than two months after the Commission was created.

- *Privatization Plan approval*

The approval process consists of the following steps:

- 1) initial approval of the draft plan by the RPF or SPF;
- 2) approval/sign off on the plan by Ministry of AIC and Antimonopoly Committee;
- 3) approval of the plan by Cabinet of Ministers (this step alone takes anywhere from 10 days to several months);
- 4) final approval by the seller - the responsible privatization body (SPF or RPF).

- *Conversion of enterprise to JSC / registration of JSC*

- *Share issue registration*

- *Creation of Share Sales Commission*

- *Preferential sale of shares to employees and management (for PPCs, CCs and cash)*

Employees submit their applications and certificates to the privatization commission. Preferential sale lasts for 3 months: 2 months for the sale, plus 1 month to finalize the payments and results.

- *Transfer of shares to suppliers and employees of suppliers (for certificates and free of charge)*

Shares included into the quota for each supplier are formally transferred to each supplier for further distribution to its employees. Distribution starts with the preferential sale of shares to employees of suppliers for PPCs, CCs and cash (a process which must last no more than 3 months). The shares left over are subject to free distribution among the employees of supplier according to the procedure approved by their general meeting (this takes one month). The whole process will take at least 4-5 months.

- *Sale of shares to suppliers (legal entities) for cash at nominal value*

Shares remaining after the conclusion of preferential sales may be sold for cash at book value to all the suppliers on the list. After that, the unsold/unreserved remainder of shares can be offered for open sale. The quota allocated for state-owned suppliers is reserved for future sale for cash at the nominal value. This sale can be completed only after the supplier has been privatized. These shares are reserved for up to 12 months from the beginning of preferential sale. After 12 months the unsold remainder of shares can be offered for open sale.

- *Open sale of shares: certificate auctions, commercial tenders, stock exchange sales*

Shares allocated for certificate auctions for PPCs or CCs in share allocation plans can be offered for sale in parallel with preferential sale. According to the CabMin protocol decisions of December 1997, shares retained in state ownership in grain industry enterprises are subject for sale through the stock exchange (packages less than 15%) or commercial tenders for cash (packages more than 15%). Shares remaining after preferential sale (if any) can be offered at open sale only after one year has elapsed since the end of preferential sales.

- *Overall time required to privatize a grain elevator*

In theory, the enterprise preparation process (from the moment of approval through the final approval of the privatization plan) can be concluded in 4 months time. Its duration greatly depends, however, on how fast the SPF, the Ministry of AIC and CabMin reach agreement on the share allocation plan. For example, the preferential sale of shares to elevator employees takes up to 3 months. The free transfer of shares to suppliers and their employees takes 4-5 months, although this can occur at the same time as preferential sales to elevator employees. Thus, if all share allocation activities are conducted simultaneously, the

process can be completed in 4-5 months. In practice the process seldom takes less than 6 months. The preparation and privatization of an elevator usually lasts from 9-12 months, although there are examples where the privatization process has lasted two years.

Valuation of Property Undergoing Privatization

Valuation consists of the following steps:

- Upon submission of recommendations by the privatization commission, the privatization body approves the composition of the inventory commission.
- Not later than 30 days after the appointed date of valuation, the inventory is completed; inventory materials (summary) and a transfer balance are delivered to the privatization commission.
- On the basis of inventory results, the «valuation act for the property complex» is compiled and approved by the SPF/RPF.
- The valuation act is valid for the purpose of an OJSC Charter registration for the period of two months only. If registration is delayed, a new act must be compiled. Some objects may be spun off as independent entities to be privatized with further compiling of a distribution balance. Unfinished construction objects can be removed, as per proposal of the privatization commission, from the integral property complex of the privatizing enterprise and be privatized in the future via auction, tender, etc. Social assets can be transferred to communal ownership (as agreed with local authorities). An enterprise's housing fund (except for dormitories) may not be included into the newly created OJSC statutory fund and may not be privatized along with the enterprise. Privatization of housing funds is regulated by a separate law.

If enterprises have independent business units which ensure permanent accommodation and storage of state reserves (including mobilization reserves), such business units shall not be subject to privatization. (reference the Law of Ukraine «On Privatization of State Assets,» 02/19/97). The value of state reserves and mobilization reserves--as well as the value of property used to accommodation and store such reserves--shall not be included into the statutory fund. Charters of JSCs, founded on the basis of enterprises responsible for storage of state reserves shall stipulate that the JSCs shall ensure the fulfillment of their mobilization assignments.

An independent audit is not mandatory to complete share issue registration.

Frequently asked questions regarding valuation:

1) How are enterprise debts accounted for in the valuation?

Accounts receivable are included in the value of the integral property complex; accounts payable are excluded from the valuation. The value of an integral property complex includes net working capital, i.e., working capital less accounts payable. If, however, the net working capital is negative, the valuation act will include the working capital valued at "0".

2) How is grain "in responsible storage" accounted for?

Inventory items in storage are accounted for by extra-balance account #002 "Inventory Items in Responsible Storage" and are not referred to in the valuation act. That is, they are not included in the valuation.

Examples of share allocation plans and resulting distribution of shares

Enterprise	State Share	Lease share	Pref. sale to employees	Free transfer to suppliers	Pref. sale to management
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Elevator #1	9.00	70.70	6.30	14.00	-
Elevator #2	26.00	53.50	9.50	11.00	-
Elevator #3	26.00	25.80	22.20	16.10	9.90
Elevator #4	3.19	14.21	46.92	35.68	-

Options Available to Foreign Investors

Investors (foreign and domestic) can obtain shares in elevators through direct participation in the privatization process or through the purchase of shares on the secondary market.

Direct Participation in Privatization Sales

Because a majority of shares are reserved for suppliers, employees, and management—and given the fact that the Government retains a state share in most elevators—it is unlikely that a strategic investor will be able to obtain controlling interest in a company through direct participation in the privatization process. Portfolio investors, however, are able to acquire shares through:

- Certificate auctions for PPCs or CCs. Auctions will continue through December 1998. A foreign investor cannot participate in a PPC auction directly - only via locally registered financial intermediaries. Although almost all participants are winners, it is impossible to say before the auction how many shares a winner at the auction will get because this depends on other bids. Usually, it is cheaper to purchase shares at certificate auction than at cash sales described below, because the market price of PPCs is about 6% and of CCs 25 % of their face value;
- Sales at Stock Exchange of the state-owned share package in the process of privatization: will be conducted for packages less than 15%;
- Sales via commercial tenders for cash of the state-owned share package in the process of privatization: will be conducted for packages from 15 to 26%.

Purchase of Shares in the Secondary Market

Other options for investors are available through the official and unofficial secondary markets. The alternatives listed below were widely used, for example, during the privatization of energy sector companies.

- to buy-out shares from employees of the elevator after preferential sale, directly or via intermediary;
- to buy-out shares from employees of a supplier after free transfer;
- to buy shares purchased initially by legal entities-suppliers;
- to buy shares through PFTS (the over-the-counter trading system); at present this option is not yet available, because the privatization of the most liquid elevators is at the initial stages.

Agro Industrial Complex Monopolies

There are numerous fully or partially state-owned AIC holding companies which exert monopolistic influence on the agro-industrial sector of Ukraine. These holding companies consist, generally, of

enterprises which are undergoing privatization but in which the state retains significant shareholdings. These “parastatals” have the potential to distort the market, eliminate domestic competition, and hinder private investment.

The state-managed holding company UkrAgroTechService, for example, dominates distribution and maintenance of large agro-machinery to Ukrainian farms. UkrAgroKhim controls the supply of fertilizer and other inputs. A new government-owned holding company, UkrAgroMashInvest, is chartered to manage the import of farm equipment components through foreign government export credit facilities and to control the distribution and leasing of domestically produced tractors and other equipment through ownership interests in Ukraine’s major farm equipment manufacturing enterprises.

Other parastatals retain control over key branches of Ukraine’s agro/agro-industrial sector include UkrAgroKhimServis, the regional OblAgroTechServis and OblAgroPostach. Another “parastatal”, “SadVinProm” (a division of the AIC Ministry), controls the wine production industry in Ukraine and the 130 state enterprises in this sector which are on the Parliament’s privatization “negative list”. The Government of Ukraine, in effect, has created holding companies to replace the earlier sub-ministerial apparatuses which had controlled Ukraine’s agro-industrial sector.

(Note: The USAID Mass Privatization Project is involved only in the privatization of Ukraine's medium and large enterprises. The USAID-funded IFC Small-Scale Enterprise Privatization Project has advised and assisted in Ukraine's privatization via auction of its small enterprises. The following report, prepared by the IFC, is included in order to provide readers with a comprehensive review of Ukraine's privatization program.)

SMALL-SCALE PRIVATIZATION

Small-scale privatization in Ukraine began on February 20, 1993, when the International Finance Corporation (IFC), funded by USAID, assisted L'viv city officials in holding the first open auction in Ukraine. It was not until the second half of 1995, however, that the small-scale privatization process gathered momentum.

Small-scale privatization has gone through several stages of development. Its pace has been dictated by three major events which have had broad implications: the 1993 "May Decree" on leasing, the "privatization moratorium" of July 1994, and the Presidential Decree on the completion of small-scale privatization of December 1994. Small-scale privatization today continues under the heavy influence of these three acts.

In February 1993, IFC assisted the city of L'viv in holding the first privatization auction in Ukraine. This was followed by a series of seminars and the publication of a manual on the L'viv privatization model, which was distributed to 6,000 towns and cities around the country. The result of these efforts was a wave of auctions scheduled initially for the spring of 1993. However, in May, a decree of the Prime Minister was issued which put an unprecedented amount of control over privatization in the hands of the workers' collectives, which are generally opposed to competitive privatization. In Ukraine, the workers' collectives of state enterprises have the right to lease the assets of the enterprise in which they work, obtaining autonomy in the management of the enterprise and in the distribution of profits, without the risks of ownership.

The "May Decree" took away the right of the cities to deny lease agreements to workers' collectives; it also gave the collectives the right, as leaseholders, to reject any initiatives of the city to privatize their enterprise. This decree led to a jump in the number of leased enterprises as workers' collectives tried to avoid privatization, cutting the number of enterprises available for privatization to a fraction of the original number.

In June 1994, after a year of battling against the tide of lease, IFC, with USAID approval, expanded its mandate to include privatization through "lease-with-buyout" - the only realistic method of getting leased enterprises, and thus the critical mass of enterprises in Ukraine, privatized (see Annex 1). In June and July of 1994, IFC began implementing this strategy in its ten client cities, resulting in the privatization of an unprecedented number of enterprises. In June alone, through a combination of public relations activities, price incentives and legal groundwork, IFC assisted in the privatization of over 1,000 leased enterprises. In August, however, the Parliament enacted a moratorium on all forms of non-competitive privatization, i.e., lease buyout, thus once again impeding small-scale privatization in Ukraine. Although during this period between 50 and 100 objects were privatized with IFC assistance per month, the potential of the new lease strategy remained unrealized.

In December 1994, a Presidential Decree "On Measures to Accelerate the Process of Small-Scale

Privatization in Ukraine" once again impacted the pace of small-scale privatization; it de facto lifted the moratorium on non-competitive privatization and called for the completion of small-scale privatization by the end of 1995. To a limited extent, this resulted in another rise in the numbers of small-scale enterprises privatized in December and January.

However, this acceleration was hindered by the reorganization of Ukrainian privatization bodies and subordination of local bodies to the State Property Fund. After January, small-scale again slowed down considerably as city councils debated which objects to privatize, local privatization organs were reorganized, and officials waited for normative documents to be approved. IFC during this period worked intensively with the central government on the normative documents, and with local governments on drawing up privatization lists and implementing the changes mandated in the Decree. It was not until April that the number of small-scale privatizations began to increase, and only in the summer did the pace of privatization begin to accelerate rapidly.

By the last quarter of 1995, Ukraine was privatizing approximately four percent of its small-scale enterprises per month. At the end of the year, an estimated 44 percent of small-scale enterprises had been privatized nationwide. In the eighteen cities assisted by IFC, over 65 percent of small-scale enterprises had been privatized; in seven of those cities over 80 percent of the small-scale enterprises have been privatized.

The current pace of small-scale privatization is unprecedented and has a firm foundation: strong support from the President and Cabinet of Ministers, capable leadership from the side of the State Property Fund, growing support from city officials at the local levels (because privatization is an important source of revenue for cash-starved city budgets) and growing grassroots approval of the small-scale privatization process. However, there are several threats which continue to hover over the small-scale process.

First, the Parliament and local legislative bodies tend to be conservative and have a history of opposing small-scale privatization in the country. A recent draft law on Small-Scale Privatization illustrated their opposition clearly -- almost every article was designed to slow down the small-scale process in one way or another. On the local level, city councils continue to be reluctant to approve lists of objects for privatization, even at the urging of the State Property Fund. Ultimately, no central level authority has the power to force them to approve these lists, even if they are not meeting the targets set by the central government.

Second, while the most progressive cities in Ukraine have already managed to privatize virtually all of their small-scale enterprises, there remains a substantial number of cities which have not yet truly begun to privatize their small-scale sectors (e.g., Poltava, Krivoi Rog, and the Autonomous Republic of Crimea). Unless these less progressive cities begin to rapidly accelerate privatization of their small-scale enterprises, the nationwide pace of small-scale privatization will drop with the elimination of those cities which have moved most rapidly in the past.

Third, smaller cities around Ukraine have significantly lagged behind their larger counterparts in the numbers of small-scale enterprises privatized. Of the small-scale objects remaining to be privatized, two-thirds are located outside of the largest 30 cities in the country. These cities have received less supervision and pressure from the central government to complete small-scale privatization, and therefore they have been moving at a more leisurely pace. A strong push will be needed to assist these cities in speeding up and completing the privatization of their objects in a reasonable time frame.

Fourth, the December Decree of the President placed a moratorium on new lease agreements and set

September 1, 1995 as the deadline for workers' collectives of leased enterprises to apply to buyout their enterprises at preferential prices. Thus, by September 1 the vast majority of leased enterprises applied for buyout, and by the end of December most cities had completed privatizing the bulk of their leased enterprises.

Thus, the reservoir of leased privatization objects will dry up in 1996, meaning cities will again have to turn their energies towards auctions, which are both more controversial and time consuming.

Finally, as more and more objects are privatized, IFC has noted that a smaller percentage of objects offered at auction are actually being purchased. This is true particularly in cities which have relatively high percentages of enterprises privatized and is probably due to a certain level of saturation of the market and the decline in the general quality of enterprises offered as cities "scrape the bottom of the barrel".

LIST OF COUNTERPARTS ADVISED

Clients and direct counterparts

Close cooperation on day-to-day basis. Providing strategy/policy/implementation advice and assistance:

- United States Agency for International Development (USAID)
- State Property Fund of Ukraine (SPFU)
- Regional Property Funds (RPFs) in 26 regions
- Ukrainian Center for Certificate Auctions (UCCA)
- Regional Centers for Certificate Auctions (RCCA) in 26 regions
- Ukrainian Enterprises being assisted by PW Enterprise Preparation SWAT Team
- Cabinet of Ministers

Ukrainian Officials/Agencies/Enterprises

Counterparts which are being contacted/provided with information/materials/proposals from time to time:

- Verhovna Rada Commission for Control over Privatization
- Verkhovna Rada Committee on economic policy and management of economy
- Presidential Administration
- Local (Oblast) Administrations
- Prime-Minister of the Autonomous Crimean Republic
- Vice Prime Minister of Ukraine on Economic Reform
- Ministry of Finance of Ukraine
- Ministry of Justice of Ukraine
- Ministry of Statistics of Ukraine
- State Securities and Stock Market Commission of Ukraine
- Savings Bank of Ukraine
- National Bank of Ukraine
- Anti Monopoly Committee of Ukraine
- Ukrainian Union of Industrialists and Entrepreneurs
- National Agency for Reconstruction and Development
- Professional Association of Registrars and Depositories of Ukraine
- The PFTS Over the Counter Trading System
- International Center of Privatization, Investment and Management
- Ukrainian Center for Post Privatization Support of Enterprises
- Embassy of the United States of America
- Interministerial Committee on Privatization of Unfinished Construction Objects
- Commercial Center for Privatization of Unfinished Construction Objects
- American Chamber of Commerce
- Trade Unions of Ukraine National Confederation
- Liberal Party of Ukraine
- Ukrainian non-State Pension Fund "Dobrobut"
- International Management Institute (IMI-Kyiv)

- VO "AutoZAZ"
- Kiev Consulting Group
- International Enterprise Foundation of Ukraine
- Ukrainian League of Entrepreneurs of Agroindustrial Complex
- Joint-Stock Company "UKRAGROBUSINESS"
- Ministry of the Agro-Industrial Complex
- Khib Ukrainy
- Inter-Ministerial Commission for Agrarian Reform
- National Exchange Association of Ukraine
- Kiev Mohyla Academy
- Ukrainian Grain Association
- Farmer's Association of Ukraine
- Ukragroconsult
- Chamber of Commerce of Ukraine

Donor organizations and their contractors

Updates, coordination on strategy and policy issues:

- The World Bank
- International Monetary Fund
- European Union / Technical Assistance to Commonwealth of Independent States
- International Finance Corporation
- British Know-How Fund
- Harvard Institute for International Development
- Financial Markets International
- Gavin Anderson/PBN
- KPMG/Barents Group
- US Peace Corps
- The Alliance (CDC-IESC-MBAS-VOCA)
- Multilateral Investment Guarantee Agency
- Organization for Security and Cooperation in Europe
- Project on Economic Reform in Ukraine (PERU)
- Center for Financial Engineering in Development
- The Eurasia Foundation
- The Citizen Network for Foreign Affairs Inc.
- Development Alternatives, Inc.
- Deloitte & Touche
- Hagler Bailly
- PADCO
- Western NIS Enterprise Fund
- Chemonics
- Embassy of Canada
- German Advisory Group on Economic Reform
- Center for Privatization and Economic Reform
- European Bank for Reconstruction and Development
- U.S. Department of Agriculture
- Carana Corporation

Commercial Companies, Financial Intermediaries, Portfolio/Institutional investors

Regular updates on privatization and investment climate in Ukraine:

- "PROMINVEST" Bank
- "AGGIO" Commercial Bank
- "KINTO" Investments & Securities
- Europa Capital Management
- ING Bank N.V. / ING Barings Asset Management
- McDonald Lehner
- Schroders
- New Capital Markets, Inc.
- Investmentbank Austria AG
- Pioneer Fund
- Ladenburg, Thalmann & Co. Inc.
- European Privatization and Investment Corporation
- Credit Suisse First Boston (Ukraine)
- Commercial Companies, Financial Intermediaries, etc.
- Cargill Enterprises
- Monsanto
- DuPont/CONOCO
- Merx, Ltd.
- Energobusiness
- Pioneer Hi-Bred International
- One World
- Goodwill
- Dow Chemical
- John Deere
- Rhone-Poulenc
- Kiev Atlantic

HUMAN RESOURCES

As with any organization, human resources - The Team - have been central to the Project's success. From the initial setup phase through the roll-out phase and towards the final phase, the Project Team has gone through many changes, both in terms of the individuals comprising the Team and the Team's structure. Its quality, however, has been consistent throughout.

In early 1995, the Project was launched with a diverse, international team of consultants from the United States, Great Britain, Canada, Lebanon, Russia, and Moldova. These international experts constituted the majority of the team at that stage, but gradual "Ukrainization" through the next two years drastically changed the composition of the Team: currently 90% of the staff are Ukrainians, while the rest 10% of the Team consists of internationals from the United States, the Netherlands, Russia, and Moldova.

Confirming the international nature of the Team, the majority of the Team members are proficient in foreign languages: 84% speak Ukrainian, Russian, and English. Fifteen other languages, including Arabic, Chinese, Danish, Dutch, French, German, Hebrew, Italian, Japanese, Persian, Polish, Portuguese, Romanian, Serbo-Croatian, and Spanish, are also spoken by one or more of the Team members.

To a great extent, the high quality of service provided by the Team is achieved due to the high educational level of the Team members. All of them have University degree, more than a quarter of the team members have completed Master of Arts programs, another quarter - Master of Science, and several hold Master of Business Administration degrees. In addition, there are 5 PhDs among the staff. Overall, almost half of the team has more than one degree awarded in different institutions, including 25 degrees obtained in international institutions outside Ukraine (see Chart 1). The most common majors for the staff include Economics and Finance, Linguistics, Engineering and Technology as well as Information Technology. Some staff have completed studies in Mathematics, Management, International Relations, Law, Physics, Chemistry, History and Public Relations (see Chart 2).

Complementing these educational backgrounds has been a concerted effort to provide continuing education opportunities to the Project staff. During two-and-a-half years, Price Waterhouse has delivered/facilitated a variety of such initiatives, including ACCA/ATC (accounting) training, a "mini-MBA" course, Change Integration® (organizational restructuring/consulting) training, privatization policy and procedures courses, Shareholder Rights Seminar, Corporate Governance Training, Quality Management Program, Myers-Briggs Type Indicator Seminar, Presentation Skills training, English Language Courses, Business Writing Skills training, Interpersonal Skills seminar, and more.

The Team's quality is further supported by the staff's different work experience prior to joining the Project. Most have worked in the Audit, Banking, Finance, Information Technology, Privatization, Science, and Sales sectors, while others come from Consulting, Production, Education, and Public Relations (see Chart 3).

A key factor to the success of the Project is the Team's professional and practical knowledge of the privatization process. This knowledge was derived from first-hand participation in some of the largest and most successful large-scale privatization projects launched in and outside the region: USAID Russia Mass Privatization, USAID Kyrgyzstan Mass Privatization, USAID Moldova Mass Privatization, USAID Bosnia Privatization, USAID Zambia Privatization. Additionally, staff participated in several Capital Markets, Accounting and Public Education Projects: World Bank Croatia Securities, USAID Moldova Capital Markets Development, USAID Kyrgyzstan Capital Markets Development, World Bank Investinform (Russia), USAID Ukraine Accounting Reform, and USAID Ukraine Market Reform Education Program.

Technically, the Project's Information Technology staff are highly qualified both as users and as programmers/technicians. The list of programming languages which the team members have mastered includes Intel 81x86 Assembler, IBM/360 Assembler, BASIC, Access BASIC, Visual BASIC, C, C++, Visual C, Clipper, dBase, FOXPRO, Clarion, COBOL, FORTRAN, INFORMIX 4GL, JCL, Pascal, Object Pascal, PL/1, PL/SQL, PROLOG, and SPL.

And finally, the Team members' superior technical and professional qualifications are underscored by their participation in various Ukrainian professional associations and organizations including the Ukrainian Tax Consultants Association, the Association of Professional Accountants and Auditors of Ukraine, the European Association of Agriculture and Economics, the FAO Network for Agricultural Policy Research and Development, and the Geography Information Systems Association (Russia). Moreover, individual team members have also been awarded with Ukrainian and international certificates for Economic Modeling (USDA), Privatization Consulting (SPF of Ukraine), Securities Brokerage (SSMC of Ukraine), Public Relations, Audit (both locally and internationally), and other subjects.

In sum, the varied breadth and depth of the staff members, combined with their cohesive, team-oriented approach to fulfilling the tasks at hand, has created a unique amalgam of experiences and perspectives. Managed effectively, this Team has proven capable of solving complex business problems under the most challenging circumstances.

MASS PRIVATIZATION PROJECT TEAM LIST

Project Management and Strategy Team

John Johnson* (Project Director)
Philippe Regnault* (Deputy Director)
Andrei Aleikin* (Deputy Director)

Privatization Policy and Procedures Team

Dmitry Scorduli* (Team Leader)
Natalia Tereshenko*
Stepan Makoviak*
Mikhailo Tereshenko
Dmitry Martynenko (lawyer)
Liliya Galanternik (lawyer)
Yelena Karpina
Natasha Kusik

Privatization Data Analysis and Research Team

Pavel Porokhov* (Team Leader)
Alex Ovchinnikov
Taras Dzeganovsky
Yuri Krutovertsev
Elena Kolisnichenko
Victoria Rovnaya
Olga Romanovitch
Alexander Mayboroda

Web Site Team

Igor Starokon* (Team Leader)
Rodion Dorichevski

Enterprise Preparation/Agro-Industrial Privatization Team

Kevin Covert* (Team Leader)
Yuri Mykhailyuk* (Regional Consulting Manager)
Olga Dovbah (AIC specialist)
Oleh Fomin* ("blue chip" enterprise specialist)
Lubov Rudenko (accounting/valuation specialist)
Natalia Shishnyaeva ("blue chip" enterprise specialist)
Yelena Trokhimenko ("blue chip" enterprise specialist)
Yana Piontkovska ("blue chip" enterprise specialist)
Mikhailo Tereshenko (AIC specialist)
Alexander Naumenko (intern)
Yuriy Fedoriv (intern)

Galina Medvedeva (central region)
Tatyana Bakh (central region)
Elena Lobachova (central region)
Gennadi Molot (central region)

Zoya Frolova (Pridneprovsky region)
Vadim Leta (Pridneprovsky region)

Oleg Verbinsky (eastern region)
Elena Osipova (eastern region)
Andrei Ptushchenko (eastern region)
Bogdan Bodnar (eastern region)
Valentina Yefremova (eastern region)

Yuri Hryvnaк (southeastern region)
Vladimir Klimenko (southeastern region)

Dmitry Logvinenko (southeastern region)
Sergei Vlasiuk (southeastern region)
Valentina Yermakova (southeastern region)

Igor Kvyatkovsky (western region)
Galina Maliborskaya (western region)
Yaroslav Vasiuk (western region)
Ludmila Burdenyuk (western region)

Yulia Ivanchuk (southern region)
Valentina Kalinina (southern region)
Elena Davydova (southern region)

Vita Cherep

Regional Information/Data Entry Coordinators

Yevhenia Leta+
Yulia Kalinina+
Olena Soprunova+
Valentina Glushko+
Tamara Zhmaka+
Yelena Filipieva +
Andriy Mesecha +
Petro Zabolotny+
Yevhen Zahudalov+
Ludmyla Buchyn+
Ihor Kotsiubiak+
Natalia Tkachenko+
Yelena Sutormina+
Vera Boltushkina+
Oleh Pidenko+
Myroslava Kuts+
Vera Demchenko+
Tatyana Kravchenko+
Olha Tyshkovets+

Auction Center Network Team

David Milli* (Information Technology team leader)
Heather Petty* (Audit team leader)
Victoria Siryachenko* (Ukraine Center for Certificate Auctions senior consultant)
Sergei Roshka* (IT)
Andrei Goncharenko (UCCA)
Valery Galamach (IT)
Vladimir Klepko (IT)
Vladimir Leonov (IT)
Irina Postol (IT)
Eugene Romanovsky (IT)
Roman Shliypak (IT)
Vladimir Terletsky (IT)
Alex Voronin (IT)
Valeria Dmitrieva* (Audit)
Evgeny Kriventsev (Audit)
Andriy Maximov (Audit)
Oksana Novakovskaya (Audit)
Alexei Zosimov (Audit)
Yulia Horbach (Audit)
Sergey Naumov (Audit)
Alexander Shulga (Audit)
Alexander Zhuravlyov (Audit)
Dan Bazarko (audit advisor)

Shareholder Registration Team

Stepan Makoviak*
David Milli*

Oleg Kiorsak
Svetlana Dereza

Project Support Team

Anya Kozeletska* (human resources/administration)

Evgenia Savchenko

Ludmila Tamarovska

Dmitriy Cherevko+

Office Maintenance

Elena Bondarenko+

Nadia Kirichenko+

Transportation

Grigori Guliy+

Victor Kravtsov+

Slava Lezarov+

Alexander Nikishin+

Oleg Raga+

Victor Serdechny+

Irina Chernenko (Translation team leader)

Pavel Bessmertny

Alexandre Bogomolov

Sergei Solovko (financial controller)

Natalia Kupriyenko

Alexander Kopnyak

MPP Team/Office Systems

Oleg Saiko

Irina Armashula

TOTAL 119 team members including

91 professional/consulting staff and

28 service/support staff

* = Board of Directors

+ = service staff

THE REGIONAL REACH OF THE MASS PRIVATIZATION PROGRAM: - AN OVERVIEW -

History and Background to Enterprise Preparation

In early 1995, following the passage of Presidential Decree #699 "On Measures for Ensuring the Citizens Rights for Using Their Privatization Property Certificates", Price Waterhouse (under contract with USAID) began to establish the nation-wide Auction Center Network (ACN). The ACN began operations in April 1995, in the thirteen oblast centers where Regional Centers for Certificate Auctions (RCCAs) were established. Price Waterhouse consultants managed many of the logistical, operational and personnel issues related to the establishment of these RCCAs. Mass privatization project staff hired, trained and organized local staff, developed systems and managed the financing of the ACN.

After setting up the network of the RCCAs, attention turned to the establishment of a nationwide network of Bid Reception Sites (BRS) in order to extend the reach of the ACN into the smaller cities and villages of Ukraine, thus permitting citizens greater access to mass privatization certificate auctions. By August 1995, a network of more than 2,000 BRSs started operations. At least 20 BRS were opened in each region in order to cover all the rayons in the regions.

At the same time, the mass privatization project assumed responsibility for overseeing the RCCAs in the remaining thirteen oblasts, opened with the assistance of Bain & Co. and financed by USAID. The project's national coverage at that time included six Regional Managers in major cities of Ukraine in addition to 22 Regional Consultants who worked in the RCCAs. Such a structure provided for adequate control over and prompt assistance to the RCCAs, including training on certificate auction methodology and procedures.

The success of the first Privatization Property Certificate (PPC) Auctions conducted by the RCCAs proved the efficiency of the ACN. However, the number of share packages offered for sales through PPC Auctions proved to be insufficient to maintain an adequate pace of mass privatization. Therefore, in the fall of 1995, project management redirected regional resources to the RPFs in order to ensure that the pipeline of joint-stock company (JSC) share packages would be sufficient to maintain the desirable pace of privatization.

The scope of work of the regional team at that time included: assistance to the RPFs in data analysis and methodology, continued monitoring of ACN financing as well as ongoing methodological support to the ACN. In addition to these activities, the Regional Consultants began assisting local enterprises during the process of privatization through seminars on privatization procedures. This was the beginning of the project's enterprise preparation (EP) assistance and it included all of the major stages of mass privatization: share allocation plan development, inventory, valuation, registration of the enterprise, registration of share emissions, and share sales.

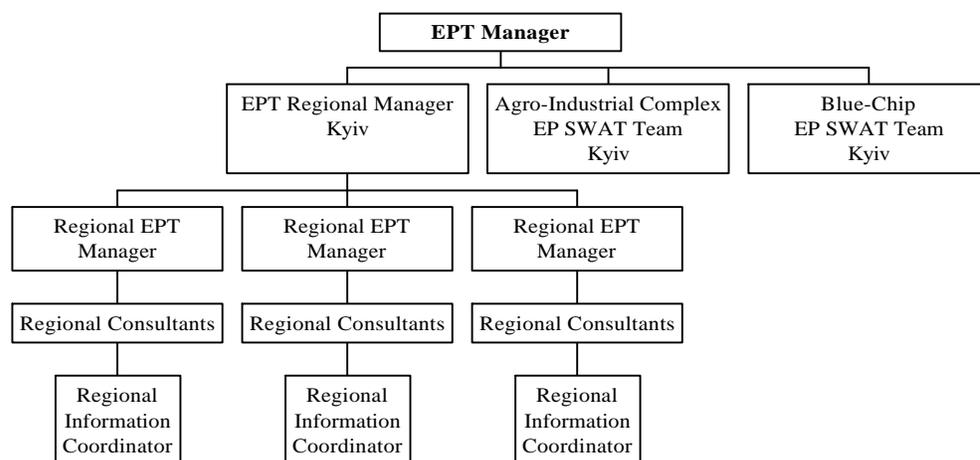
The Enterprise Preparation Team (EPT)

From January 1995 through April 1998, the Enterprise Preparation team provided privatization-related assistance or training to 576 medium- and large-scale Ukrainian enterprises. Methodologies and manuals written by EPT specialists were constantly in high demand and, while their impact is difficult to quantify, it is certain that they facilitated the work of the State Property Fund and Regional Property Funds.

By early 1997, it had become clear that a small number of large, attractive industrial enterprises accounted for the majority of certificate investment in PPC and CC auctions. Accordingly, the strategy of the regional team was changed and focused exclusively on the preparation of such large, “Group D” industrial enterprises. A new, mobile team of experienced privatization consultants, dubbed the “Blue Chip Team,” was established to provide direct, step-by-step EP consulting to these enterprises. In an eighteen-month period, this small team of procedural specialists, accountants and valuation experts assisted 50 large industrial enterprises managed by privatization officials from the SPF’s Central Office.

With the introduction of a new incentive-based financing arrangement with the ACN in January 1998, the team gradually phased out its assistance to the RCCAs. As shown below, the enterprise preparation team was reorganized into two specialized teams—one dedicated to helping the largest industrial companies, the other focused on Ukraine’s agro-industrial complex—and 23 Regional Consultants divided into 6 teams based in the major cities of Donetsk, Dniepropetrovsk, Zaporizhe, Odesa, Kyiv and L’viv.

The nation-wide reach of the enterprise preparation team was further extended through a network of regional information coordinators, who were relied upon to enter, verify and monitor official certificate auction data. In addition to fulfilling specific tasks and searches, these data specialists helped keep the mass privatization team informed about the GOU’s progress in meeting its depth-of-sale targets (e.g., 8000 medium- and large-scale enterprises sold to 70% by the end of September 1998).



The enterprise preparation team as a whole continued to deliver regional training seminars throughout the country, with Kyiv-based specialists working together with their regional colleagues to ensure high quality, thematic consistency, and up-to-date methodologies. Over a twelve-month period from 1997-98, EP consultants delivered separate training seminars for enterprise leaders and RPF officials on valuation, audit, and shareholder rights in each of the “Big Six” cities listed above. In July 1998, with the end of the mass privatization project fast approaching, the EPT conducted a seminar to transfer EP skills and methodologies to private consulting firms that might be in a position to continue to provide EP consulting to enterprises without USAID assistance.

Together with the project's legal team, the EPT advised the State Communications Committee on the privatization of Ukrtelecom, with special emphasis placed on preferential share sales procedures and valuation. Project lawyers prepared and submitted to the State Communications Committee a draft "Law on Peculiarities of Privatization of the Telecoms Sector" which includes preferential share sales for certificates to 133,000 employees. Other examples of joint EPT/legal team assistance include the preparation of a corporate charter and shareholders' meeting consulting to Dnieproenergo and Zakhidenergo.

Enterprise preparation consultants also researched, designed and drafted a case study for use in post-privatization training seminars. The Red October Chemical Machinery Works case study was developed in 1997 as an educational tool to investigate problems faced by former state-owned Ukrainian companies that had completed the certificate privatization program. The case study addresses the issue of raising capital and is designed for use by training institutes conducting seminars on business and financial management for directors of newly privatized companies. The case study will be useful for a discussion of capital raising options, enterprise management strategies and financial management in the post-Soviet environment.

Demonopolization and Privatization of the Agro-Industrial Complex (AIC)

In November 1997, the Cabinet of Ministers (CabMin) issued a Resolution that was to greatly affect the activities and structure of the EP team. Resolution #1218 launched the demonopolization of Khib Ukrainy (KU), the Government's grain processing, distribution and marketing monopoly. The Resolution listed 542 grain storage, processing and marketing enterprises ("grain elevators"), 442 of which it declared eligible for privatization.

Since the very early stages of the privatization program in Ukraine, the international donor community has taken a keen interest in the privatization of the agro-industrial complex. For example, the International Monetary Fund included specific targets for elevator privatization in the \$2.5 billion External Fund Facility (EFF) loan and the Gore-Kuchma Commission agreed that all but 100 of Ukraine's grain elevators should be privatized. By June 1998, the resources, skills and abilities of the EP team were 100% focused on demonopolizing Khib Ukrainy and privatizing Ukraine's grain elevators.

Mass privatization consultants working in major AIC regions throughout the country have since become integral to the agro-industrial privatization efforts of the State Property Fund. Kyiv-based consultants provide senior-level strategic policy advice, draft legislation and methodologies, and prepare GOU implementation orders. In the regions, EPT AIC specialists conduct counterpart training seminars, and maintain databases on the pace and depth of privatization of AIC monopolies, holding companies, and other AIC enterprises.

In addition, the AIC consulting team has designed and taught a series of regional seminars to accelerate the privatization of the grain processing industry. Over 300 elevators, most of them former Khib Ukrainy enterprises, have participated in 25 seminars held since November 1997. Each participating enterprise received "how-to" privatization manuals detailing the steps involved in enterprise preparation and share sales. These manuals include relevant governmental policies and procedures (including laws, resolutions, decrees and forms) and have been extremely popular among enterprises seeking to break away from KU control.

Problems Encountered

Despite the likelihood of reaching 8,000 enterprises privatized by September 30, 1998, certain problems arose during the enterprise preparation process that slowed the overall pace of

privatization. In most cases, the successful resolution of these problems required the resolve, leadership and support of the State Property Fund.

Among the problems hindering the effectiveness of the EPT were the reluctance of the SPF to officially endorse and recommend PW enterprise preparation assistance, a lack of transparent privatization data, stalling tactics by branch Ministries and enterprise directors, the Cabinet of Ministers review of share allocation plans for large and/or monopolistic enterprises, and enterprise restructuring carried out during the privatization process.

Lessons Learned

1. Focus on Quality. The EPT focused on preparing quality enterprises for privatization because their participation promotes popular involvement and private investment.
2. Cooperate. Mass privatization consultants were most effective when working together with the SPF, sharing information, experience, skills and ideas.
3. Ensure Transparency. Accessible, accurate information was critical to enterprise preparation and auction planning. Without lists of enterprises to be privatized, lists of enterprises already privatized, and lists of strategic enterprises excluded from privatization, it was more difficult to ensure a more open, honest and fair privatization process, which has been the common aim of the SPF and USAID.

PUBLICATIONS

In the course of project implementation, the following privatization-related guides were prepared, published and distributed to government officials and enterprise directors throughout Ukraine:

Step by Step Guide to Enterprise Preparation (571 copies in Ukrainian).

In November 1994, the President of Ukraine issued Decree #699 "On Measures for Ensuring the Rights of the Citizens of Ukraine to Utilize Privatization Property Certificates". In compliance with the Decree, this Guide outlines the regulatory and methodological framework for the transformation of a state-owned enterprise into an open joint-stock company and for the open sale of its shares. It provides the managers of an enterprise undergoing privatization - as well as privatization officials - with all relevant information regarding what documents are needed and in what time period they should be prepared, to whom they should be submitted, and what actions should be taken in the corresponding stages of an enterprises preparation for privatization.

Guide to the Valuation of Enterprises Subject to Privatization (5,300 copies in Ukrainian and 250 copies in English).

Performing the valuation of an integral property complex subject to privatization is an important and complicated issue. "Guide to the Valuation of State-Owned Enterprises Subject to Privatization in Ukraine" was created in order to provide practical assistance to the managers of an enterprise being privatized as well as privatization officials.

Along with methodological recommendations, this Guide contains the legislative framework for the valuation of state-owned and leased enterprises. At the same time, it contains not only a set of theoretical materials but also includes examples showing the practical application of the methodology. The reader is encouraged to complete the protocols of valuation of property for various types of enterprises and is provided with detailed instructions on calculating the value of an enterprise's property. Such exercises make it easier to understand this complex subject.

Guide to the Preferential Sale of Shares (3,550 copies in Ukrainian and 100 copies in English).

The preferential sale of shares is an important step in the privatization process due to the fact that it is the first point at which the transfer of ownership begins from state to private hands. The Guide outlines the regulatory and methodological framework for the completion of an enterprise's preferential sale of shares to employees, management, and other entitled individuals. It is designed to assist state-owned enterprises that have not started the privatization process, 100% state-owned joint stock companies, and enterprises that are leased by the SPF.

The Guide provides SPF staff and enterprise directors and staff with all relevant information regarding who can participate in the preferential sale, instructions for the appropriate groups, procedures for conducting the preferential sale, other relative legislation, and a software program that allows the enterprise to process applications and create an electronic database of individuals who will eventually become the shareholders of the enterprise. Once this database

is created, the enterprise can effectively update and eventually transfer the data to its shareholder registrar in an organized and timely manner.

The Guide to Mass Privatization in Ukraine (250 copies in Ukrainian, 200 copies in Russian and 200 copies in English).

The Guide outlines the key points of Ukraine's transition to market economy and describes the basic concept of the Mass Privatization Program in Ukraine. It contains a brief summary of the history of Mass Privatization in Ukraine and a review of the regulatory framework created for its implementation. While providing the reader with the basic principles of a market economy, the Guide provides specifics on the Mass Privatization Program. In this Guide, one can find summaries of enterprises eligible for privatization, the auction network, certificate auctions, financial intermediaries, and shareholder registries. This Guide is intended as a primer for privatization officials, government officials, the public and potential investors in Ukraine's industry.

Step-by-Step Guide to the Privatization of Agro-Industrial Complex (AIC) Enterprises (1,800 copies in Ukrainian).

This Guide is intended for agro-industrial privatization specialists of the SPF and directors of AIC enterprises to be privatized. It considers the specialized privatization program for enterprises in the AIC.

The Guide contains information on the AIC privatization procedures for an individual enterprise, including:

- step by step implementation of required measures for the privatization of AIC enterprises;
- lists and sample forms of required privatization documents and the order of their submission;
- documents comprising the legislative and methodological basis for transforming a state enterprise into an open JSC and transfer and sale of its shares;
- a summary of the theory behind AIC privatization.

AIC enterprises privatization guide :

“Step by Step - Part 1. Privatization of non-agricultural AIC enterprises through share sales”

“Step by Step - Part 2. Share sales to agricultural producers on a preferential basis”

(1000 guides in Ukrainian)

The guide contains the following information:

- a brief summary of the methodology for non-agricultural AIC enterprises privatization;
- measures to be taken to privatize AIC enterprises (step by step);
- sample documents necessary for privatization process;
- procedures for the submission and approval of the above documents;
- the documents that constitute legal and methodology framework to transform a state-owned enterprise into an open joint stock company.

“Step by Step: Grain Industry Enterprises Privatization” Guide

This Guide is intended for agro-industrial privatization specialists of the SPF and directors of AIC grain industry enterprises to be privatized. It outlines the privatization program for AIC

grain industry enterprises, taking into account the peculiarities of non-agricultural enterprises privatization (grain industry enterprises are technically considered non-agricultural enterprises).

In addition, the Guide analyzes the privatization of those grain procurement and storage enterprises which are responsible for the storage of mobilization reserves.

Share Issue Registration Guide (890 copies in Ukrainian).

In order to ensure the prompt and correct implementation of all privatization procedures, the parties concerned should be provided with accurate information regarding the regulations governing each stage of the privatization process. This Guide explains the stage at which the registration of share issues is conducted for open joint-stock companies created in the process of privatization. The Guide was compiled on the basis of the regulatory and legislative acts governing the registration of share issues. The Guide is intended for the directors, managers and legal advisors of state enterprises undergoing privatization as well as for officials of the State Securities and Stock Market Commission of Ukraine and the SPFU.

Guide to the Transformation of State Ownership in Mass Privatization and the Registration of Shareholders (5,600 copies in Ukrainian).

This more comprehensive Shareholder Registration Guide is a study and overview of the existing legislation and regulations governing compilation and maintenance of enterprise shareholder registries and shareholder registration by independent registrars. It provides an explanation of basic securities market concepts, e.g. Issuer, Share, Shareholder, Shareholder Registry, Shareholder Registrar, Financial Intermediary, Shareholder Rights, etc. The Guide explains how these concepts relate to one another and the basic principles of the functioning of a securities market. The Guide is targeted to the directors and managers of state-owned enterprises to be privatized and transformed into open joint stock companies.

Guide to Regulations Governing the Operations of the Auction Center Network and the Conduct of Certificate Auctions (360 copies in Ukrainian and 50 copies in English).

The Guide is an overview of legislation and regulations governing the auction center network and privatization property certificate auctions. The Guide includes relevant Presidential Decrees, Cabinet of Ministers of Ukraine resolutions, State Property Fund regulations and procedures, Ukrainian Certificate Auction Center orders and instructions, as well as Ministry of Finance and National Bank of Ukraine regulations. These documents contain information regarding key issues of privatization via certificate auctions. The thematic structure of the Guide makes it easier to find the specific documents governing auction center infrastructure, procedures for conducting certificate auctions including pre-auction procedures, bid reception procedures for citizens and financial intermediaries, auction results reporting procedures, and storage, accounting and cancellation of PPCs. The Guide serves as a manual for specialists involved in conducting certificate auctions.

Guide to the Regulatory Framework for Compensation Certificates (450 copies in Ukrainian and 50 copies in English).

The Compensation Certificate (CC) is a security issued to compensate citizens' savings in the national Savings Bank and the State Insurance Company which were lost during the hyperinflation of the early 1990s. CCs were introduced by Presidential Decree #698/94 of November 24, 1995, "On the Compensation of Losses Incurred by the Citizens of Ukraine due to the Devaluation of Their Savings in the Saving Bank of Ukraine and the State Insurance

Company of Ukraine". The Decree provides for compensation in the form of a privatization security which is freely tradable and used for investment in shares of state enterprises being privatized.

The Guide consists of eight thematic sections which explain the regulatory framework for:

- CC introduction and circulation;
- supply of state assets in exchange for CCs;
- CC distribution through the Savings Bank of Ukraine and Ukrainian State Insurance Company;
- conducting specialized certificate auctions for CCs;
- usage of CCs in the preferential sale of JSC shares;
- accounting, storage and cancellation of CCs through the banking system.

The Guide contains Presidential Decrees, Cabinet of Ministers of Ukraine resolutions, State Property Fund regulations and procedures, Ukrainian Certificate Auction Center orders and instructions, as well as Ministry of Finance and National Bank of Ukraine regulations.

The Guide is intended for officials involved in conducting CC auctions, investors and the public.

Guide to Corporate Governance and Competitiveness

The Guide is for enterprise directors and board members and was prepared for participants in the "Corporate Governance and Competitiveness" seminars which were conducted in various regions of Ukraine during the summer of 1995 and fall of 1997. This course, developed by Price Waterhouse in collaboration with the International Center for Privatization in Kyiv and funded by the United States Agency for International Development, was intended to provide corporate directors with practical tools and approaches for creating effective governance structures. The course involved presentations by foreign and Ukrainian business strategy experts, as well as case studies of recent privatization and corporatization experience in Eastern Europe and the CIS. The course consisted of four modules: advantages of a joint stock company in a market environment, decision-making mechanisms, information and communication mechanisms for effective decision-making and corporate restructuring and finance. Together with the presentation slides for these modules, the Guide contains information regarding the German and US models of corporate governance, voting procedures, sample proxy statements, checklist for organizing a general meeting, etc.

Guide to Conducting Inventory of Enterprises' Property (960 copies in Ukrainian).

Current enterprise accounting regulations require that all enterprises systematically conduct a comprehensive inventory of property and financial obligations. The inventory is required prior to the privatization of state owned and leased enterprises. Conducting inventory is necessary to determine the status and relative value of an enterprise's assets as well as to prevent possible misappropriations and violation of the interests of the seller (the state) and the buyers/future shareholders.

The Guide provides the managers of enterprises to be privatized - and privatization officials - with answers to questions which emerge in the process of preparing and conducting inventory, compilation of inventory reports, how to resolve discrepancies discovered in the inventory accounting process, how to reflect such discrepancies in the accounting statement, in addition to other practical inventory issues.

Guide to Valuation, Accounting and Audit Procedures to be used during Privatization

This guide is intended for SPF experts and enterprises managers and accountants. The guide was prepared for the participants of regional seminars held during fall of 1997 and in 1998.

The guide explains how to use accounting data in the valuation process including the procedures for preparing valuation documents and the Transfer Balance. Also included is a description of fixed assets audit with an explanation of depreciation rate calculation.

The guide explains the SPF requirements on format and content of the audit summary; the necessity of an internal audit, procedures to be used while accounting and reporting transactions; accounting for profit and losses of enterprises, and compiling an introductory balance sheet of an open joint stock company.

Guide to sale and purchase of OJSCs share packages via commercial tenders or stock exchange.

The guide contains information related to the organization and conduct of corresponding types of JSCs competitive share sales.

Requirements to potential buyers and the list of documents to be submitted to the competition committee by the bidders are included.

The guide includes legal and normative acts regulating the process of sale and purchase of JSCs' shares via tender.

POLICIES AND PROCEDURES DRAFTED

The following are privatization-related, officially approved documents drafted by/with the assistance of Price Waterhouse consultants and entered into a Policies and Procedures Database. The team was asked to help draft these policies and procedures as a result of previous work on:

- Privatization Programs for 1996, 1997 and 1998,
- enterprise preparation for privatization,
- share allocation via different types of sales,
- certificate auctions,
- sales for compensation certificates,
- cash sales through the Auction Center Network,
- evaluation of enterprise attractiveness based on certificate auction results, and
- privatization of grain marketing, distribution and processing agro-industrial enterprises.

<i>Name of the Document</i>	<i>Type of the Document</i>	<i>Date Approved</i>
PRIVATIZATION PROGRAM		
On Tasks and Peculiarities of State Property Privatization in 1996	<i>Presidential Decree</i>	19/03/96
1997 State Privatization Program	<i>Law</i>	03/06/97
Streamlining Privatization and Preventing Negative Consequences in this Process	<i>Cabinet of Ministers (CoM) Resolution</i>	22/02/96
State 1998 Privatization Program	<i>Law</i>	02/12/98
Draft Law “On <u>UKRTELEKOM</u> State Enterprise Privatization”	<i>Law</i>	Submitted for consideration
Draft Law “On the <i>Peculiarities of Strategic Enterprises Privatization</i> ”	<i>Law</i>	Submitted for Consideration
ENTERPRISE PREPARATION		
Instruction On RCCA Assistance to Enterprises on Corporatization	<i>UCCA Instruction</i>	01/03/96
Instruction On RCCA Assistance to Enterprises on Preferential Sale.	<i>UCCA Instruction</i>	09/02/96
On the creation of the Central Enterprise Preparation Task Force (CEPTF)	<i>SPF Order</i>	04/03/96
On approving standard documents on privatization and beginning enterprise preparation	<i>SPF Order</i>	30/04/96

Regulation on Standard Share Allocation Plan of JSC created in accordance with Presidential Decree #699/94 as of 26.11.94	<i>SPF Regulation</i>	28/08/95
Resolution of SPF # 39 as of 03/14/96 On Regional EPTF Task List	<i>SPF Resolution</i>	14/03/96
Methodology of Property Valuation in the Process of Privatization	<i>CoM Regulation</i>	15/08/96
On Approval of the Procedure for the Purchase of Shares for the Privatization Deposit Accounts Balances	<i>SPF Order</i>	15/05/97
Regulation # 705 on the Procedure for Conducting OJSCs' Shares Sales on the Preferential Basis	<i>SPF Order</i>	08/07/97
<i>DNIPROENERHO</i> OJSC draft Charter; internal regulations for the establishment and activity of executive and supervision bodies of the OJSC	<i>OJSC corporate documents</i>	<i>Agreed by SPF 03/98. Approved by Shareholders on 03/24/97</i>
<i>ZAKHIDENERHO</i> OJSC draft Charter; internal regulations for establishment and activity of executive and supervision bodies of the OJSC	<i>OJSC corporate documents</i>	Submitted for Consideration

SHARE ALLOCATION PLANS

On the procedure for reviewing the JSC share allocation plans to provide for sale of their shares at specialized auctions for compensation certificates, Order #431	<i>SPF Order</i>	12/04/96
Clarification regarding the procedure for reviewing the JSCs share allocation plans as per the SPF Orders #431 as of 04/12/96, #588 as of 07/07/97	<i>SPF Instruction Letter</i>	1996-98
On JSCs privatization plans tailoring and share allocation plans review, SPF Orders #701, #588	<i>SPF Order</i>	07/07/97 25/03/98

SHARE ALLOCATION

Regulation on the procedure for deciding share packages of OJSCs	<i>SPF, SSSMC and AMC Order</i>	04/08/97
Regulation on the procedure for the preparation and conduct of open sales (tenders)	<i>SPF Order #1520</i>	25/12/97
Regulation on the procedure for the conduct of specialized cash auctions, with relevant addenda	<i>SPF, SSSMC and AMC Order # 863/113/5</i>	04/05/98
Regulation on the procedure for the selection on a competitive basis of advisors and authorized person to prepare OJSCs share packages competitive sales	<i>SPF Order #1304</i>	03/07/98
Regulation on the procedure for the preparation and conduct of open sales (tenders)	<i>SPF Order #1303</i>	03/07/98
Instruction on the procedure to be used by the UCCA for processing bids and payments and for consolidating data and auctions results calculation.	<i>SPF Order #1291</i>	01/07/98

AGRO-INDUSTRIAL COMPLEX

Draft Veto to the Law on Peculiarities of Privatization of Property in Agro-Industrial Complex (AIC)	<i>Veto</i>	30/01/96
On the Peculiarities of Property Privatization in AIC (#290)	<i>Law of Ukraine</i>	10/07/96
On Enterprises to be Privatized Considering AIC Privatization Peculiarities	<i>CoM Resolution</i>	12/06/96
On the Acceleration of Property Privatization in Agro-Industrial Complex and Streamlining of Procedures	<i>CoM Resolution</i>	19/07/96
On the Transformation of State, Leased and Mixed Property Status Enterprises Into Joint Stock Companies Undergoing Privatization	<i>CoM Resolution</i>	11/09/96
On the Privatization of State Shares in Interbusiness Associations	<i>SPF Regulation</i>	07/02/96
On the Privatization of AIC non-agricultural enterprises and organizations, with corresponding modifications, modified as per the SPF Order of July 31, 1997	<i>SPF Regulation</i>	09/08/96 31/07/97
On the standard privatization plan for non-agricultural enterprises of AIC	<i>SPF Regulation</i>	09/08/96
On the Privatization of Agricultural Enterprises of AIC	<i>SPF Regulation</i>	09/08/96
On the Registration of Documents with Privatization Bodies	<i>SPF Resolution</i>	12/06/96
On Modifications to the Regulation on the Procedure for privatization of property of the state farms and other state-owned agricultural enterprises including the leased enterprises, established on the basis of such enterprises	<i>SPF Order</i>	08/12/96
On the Acceleration of Grain Procurement and Storage Stations	<i>CoM Resolution</i> <i>#1218</i>	05/11/96

CERTIFICATE AUCTION INFRASTRUCTURE

PW-USAID/UCCA/Oschadny Bank Agreement On Joint Activity Related To The Operating and Financing Of The Oschadny Bank Bid Reception Sites Network In Ukraine	<i>Agreement</i>	31/01/96
PW-USAID/UCCA/Oschadny Bank Contract on Compensation Certificates	<i>Agreement</i>	21/02/96
PW/UCCA Financing Agreement	<i>Agreement</i>	01/02/96
PW/UCCA Transition Financing Agreement	<i>Agreement</i>	11/03/97
PW/UAC Final Phase Financing Agreement	<i>Agreement</i>	28/03/97

PRIVATIZATION PROPERTY CERTIFICATES

Regulation on the Mode of Access to Certificate Auction Information	<i>SPF Regulation</i>	14/11/95
Regulation on the Establishment and Functioning of BRSs	<i>SPF Order</i>	28/08/95
Regulation on the Procedure for Determination of Shares Auction Price - new version (without price limitation) as per the SPF Order #604 of March 27, 1998	<i>SPF Order</i>	20/06/95 27/03/98
Regulation on the Procedure for Conducting Certificate Auctions, modified per CoM Resolution of November 25, 1996	<i>CoM Resolution</i>	27/03/95 25/11/96
On approving the regulation “On the Procedure for Submitting Bids By Citizens of Ukraine to Purchase Shares Offered for Sale at the Certificate Auctions”; corresponding UCCA Instruction of September 27, 1995	<i>SPF Regulation</i>	10/08/95
Regulation on the Procedure for Settlements for Purchased Privatization Objects	<i>SPF Regulation</i>	02/11/92
Temporary Regulation “On the Procedure for Holding Regional Certificate Auctions in Specific Regions”	<i>SPF Regulation</i>	21/02/96
Regulation on the Procedure for Submitting Applications by Financial Intermediaries and Buyers Associations for Purchase of Shares Offered for Sale at Certificate Auctions, modified as per the SPF Order #603 of March 20, 1998	<i>SPF Regulation</i>	26/03/96 20/03/98
Regulation On Terms for the Storage, Accounting, and Cancellation of Privatization Property Certificates in Banking Institutions	<i>NBU Regulation</i>	14/03/95
On Ensuring Participation of Financial Intermediaries and Buyers Associations in Certificate Auctions	<i>SPF Order</i>	19/04/95
Instruction Letter On the Temporary Procedure for Submitting Applications by Financial Intermediaries and Buyers’ Associations to Regional Certificate Auction Centers	<i>SPF Instruction Letter</i>	07/06/96
On the Introduction of changes to some SPF Regulations as per the CoM Resolution #1416 as of 25.11.96 On introducing changes and amendments to the Regulation on the Procedure for conducting certificate auctions	<i>SPF Order</i>	11/02/97

COMPENSATION CERTIFICATES

On the Procedure for Circulation of Certificates Issued to Compensate the Losses Incurred by the Citizens of Ukraine due to Devaluation of Their Savings in the	<i>CoM Resolution</i>	07/02/96
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Saving Bank of Ukraine and Former Ukrderzhstrakh Institutions		
On the Procedure for Sale of Shares of Open JSC for Compensation Certificates Through Certificate Auction Centers and the relevant UCCA instructions of 11/04/96 and 18/07/96 on collection and primary processing of bids from individuals	<i>CoM Resolution</i>	28/03/96
Regulation On the Procedure for Conducting Specialized Certificate Auctions For Compensation Certificates	<i>SPF Regulation</i>	05/04/96
On Reviewing Enterprise Share Allocation Plans to Provide for Sale of Shares at Specialized Auctions for Compensation Certificates	<i>SPF Order</i>	12/04/96
Regulation on the Procedure for Accounting, Terms of Storing and Cancellation of Compensation Certificates at the Banking System Institutions	<i>NBU Regulation</i>	05/06/96
Procedure for Purchasing Shares at Their Nominal Value for Compensation Certificates by Enterprises Management	<i>SPF Regulation</i>	14/05/96
Instruction Letter to CoM Resolution #161 as of 02/07/96 On the Procedure for Circulation of Certificates Obtained by Citizens of Ukraine as a Compensation of Losses Incurred by the Devaluation of Money Savings in the Institutions of the Savings Bank and Former Ukrderzhstrakh.	<i>SPF Instruction Letter</i>	15/05/96
Changes And Amendments To The Regulation On Applying Means Of State Enterprises Property Privatization, Approved By The Order Of The SPFU #56 As Of 02/04/93	<i>SPF Order</i>	05/05/96
On Making Changes to Some Privatization Regulations in Connection with the Implementation of Monetary Reform	<i>SPF Order</i>	03/10/96
Procedure for drawing up and submitting reports on the payment for shares of JSCs, purchased at specialized compensation certificate auctions	<i>SPF Regulation</i>	25/12/96
Regulation on the Procedure for Processing of Compensation Certificates and Applications barred from Participants in Specialized Certificate Auctions	<i>SPF Regulation</i>	05/12/96
On Introducing Changes to the CoM Resolution #161 as of 02/07/96 On the Procedure for Circulation of Certificates Issued to Compensate the Losses Incurred by the Citizens of Ukraine due to Devaluation of Their Savings in the Saving Bank of Ukraine and Former Ukrderzhstrakh Institutions	<i>CoM Resolution</i>	24/01/97
Instruction on the Procedure for Processing, by Regional Centers of Certificate Auctions and Bid	<i>UCCA Instruction</i>	04/02/97

Reception Sites, of Compensation Certificates and Applications from Physical Person and Legal Entities barred from Participation in Specialized Certificate Auctions

On the Sale of Shares for Compensation Certificates to the management of JSC	<i>SPF Instruction Letter</i>	05/03/97
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MONETARY REFORM

On Changes and Additions to the SPF Regulations in View of the Monetary Reform	<i>SPF Order</i>	12/11/96
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SHAREHOLDER REGISTRIES

On the Transfer by Certificate Auction Centers of the Information Related to Share Registry System	<i>SPF Order</i>	17/10/96
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On the Transfer by Certificate Auction Centers of the Information Related to Share Registry System	<i>UCCA Order</i>	23/10/96
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On Approval of the Regulation on the Procedure for Transfer of Shareholders Information to the SPF and Issuers	<i>SPF Order</i>	02/07/97
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PRIVATIZATION DATA ANALYSIS TEAM ("PDAT")

The team is composed of programmers and experienced analysts. All team members are fluent in English and have two to three years experience in accumulating data from multiple sources, in comprehensive analysis of privatization data, and in generating reports widely used by the State Property Fund, the Cabinet/Government of Ukraine, and the international donor and investor communities.

The PDAT experts are well acquainted with methodology, procedures and history of privatization in Ukraine. PDAT has an excellent insight regarding the internal organizational structure of the State Property Fund of Ukraine, on procedures applied to the circulation of documents and the exchange of information between the SPF Central Office and the Regional Property Funds, as well as between the SPF and other state agencies. Along with excellent working relations with the officials of the SPF officials, this experience has allowed PDAT to directly consult major SPF Departments and other ministries and agencies of the GOU.

Cooperating with all privatization-related state agencies, PDAT specialists assist the SPF, the Cabinet of Ministers of Ukraine, the Anti Monopoly Committee, branch Ministries and the Securities Commission in the areas of data flow organization, adjustment of information and statistical reports generated by the above agencies, verification and electronic processing of various data.

PDAT on a regular basis provides updated information generated by team members along with statistical and analytical materials, conclusions and recommendations to the following institutions:

1. International donors (USAID, IFC, WB, IMF, TACIS, EBRD etc.)
2. State agencies of Ukraine (State Property Fund, Cabinet of Ministers, Anti Monopoly Committee, branch ministries, etc.).
3. PW MPP enterprise preparation and policy and procedures consultants.
4. PW MPP Web Site team (for the support of the SPF's privatization Web-site).

PDAT has become practically the only independent provider of unbiased analytical data for the above institutions. The materials prepared by PDAT provide for accelerated privatization and greater transparency for potential investors as well as for the management of the privatization process by the SPF and the state.

DATABASES DEVELOPED AND MAINTAINED BY THE PDAT SPECIALISTS

DATA UTILIZED BY THE PW MPP CONSULTANTS TO ANALYZE THE PACE OF PRIVATIZATION

1. Database of results of the privatization auctions held by the Auction Center Network (ACN).

UKRAINE.mdb database purpose:

- provide the PwC MPP management and clients with PDAT-generated current status reports on quality of proposition and on the results of on-going privatization auctions;
- enable an untrained user to obtain generalized statistics regarding certificates distribution and the ACN privatization auctions results with break-down by oblasts, time periods and groups of enterprises, participating in the auctions;

- enable PDAT and the PwC MPP experts to analyze effectiveness of various types of sales, monitor general trends in OJSCs state-owned share packages sales through ACN to prepare proposals on improvement and acceleration of the privatization process;
- enable PDAT and the MPP experts to more comprehensively comply with the clients' demands by generating new formats of standard and non-standard statistical reports reflecting the status of share packages sales through the ACN;
- verify and correct the data published by the SPF and contained in the ETAP-AUCTION information system, maintained by the SPF;
- support analytical section of the SPF Internet Privatization Web-site.

Data accumulated and stored in the UKRAINE.mdb by PDAT members

- monthly reports of Ukraine's *Savings Bank* and *Oranta* National Insurance Company on the certificates (PPCs and CCs) collected by citizens with break-down by regions;
- the SPF and UCCA data on supply levels and on share sales results during the PPCs, CCs, and cash auctions, held by the ACN;
- the SPF and UCCA data on number of the applications, certificates and cash, collected from individuals and entities for the ACN privatization auctions;
- the PDAT calculations enabling to perform more profound analysis of the ACN privatization auctions results;
- background data on more than 6.5 thousand enterprises, participating in the privatization auctions (such as name, address, type of activity, relationship to AIC, group of enterprise);
- share allocation plans of the enterprises, participating in the privatization auctions, obtained from official publications in the press.

2. Database of Enterprises, Scheduled for Participation in the Mass Privatization Program during 1992-1998.

Purpose of the PLAN.mdb database

- store, update and verify the general list of 11,000 medium/large enterprises targeted by the SPF for privatization in 1995-1998;
- enable user to track the history of the enterprises planning for privatization with break-down by regions;
- enable user to consolidate and analyze the reasons of delays in the enterprises privatization process;
- enable user to analyze the status of the 1995-1998 Privatization Programs fulfillment;
- enable user to verify various SPF-generated lists of the enterprises to make specific requests, to perform objects (enterprises) search;
- support analytical section of the SPF Internet Privatization Web-site.

Data accumulated and stored in the PLAN.mdb database by the PDAT members

- consolidated by the PDAT members soft copies of:
 1. hard copies of Cabinet of Ministers Resolutions #343 of 05/15/95, #538 of 07/20/05, #1218 of 11/05.97, received from the SPF IT Department during 1995-1998;
 2. hard copies of the SPF orders, received during 1995-1998 from Ownership Reform Department of the SPF.
- summaries of all accessible official and unofficial information on privatization of the scheduled enterprises, which has been for three years gathered by the PDAT members with the SPF assistance.

3. Lists of Enterprises Prohibited from Privatization (NEGATIVE.mdb), of monopolists (MONOPOL.mdb) or of those strategically important for the economy of Ukraine (STRATEG. Mdb).

The purpose of NEGATIVE.mdb, MONOPOL.mdb, STRATEG.Mdb databases.

- store, verify and amend the general lists of enterprises, that has been officially:
 1. prohibited from privatization by the Resolutions of Verkhovna Rada of Ukraine during 1995-1998 (more than 5,000 enterprises);
 2. recognized by the Antimonopoly Committee as monopolists on the national market (more than 400 enterprises);
 3. recognized by the Cabinet of Ministers as strategically important for the economy and security of Ukraine (almost 1,000 of enterprises).
- enable to analyze the relevant lists of enterprises;
- prepare proposals on removal of some enterprises from the negative lists and their preparation for privatization;
- perform on-line analysis of the modifications to be made by Cabinet of Ministers or other institutions in the negative lists;
- enable to analyze the progress in the process of privatization of monopolists and strategically important enterprises;
- enable to monitor the process of Ukraine's economy demonopolization;
- verification of various lists of enterprises received from the SPF;
- maintaining an analytical section of the SPF WEB-site.

Data accumulated and preserved by the PDAT members in NEGATIVE.mdb, MONOPOL.mdb, STRATEG.mdb.

- soft copies prepared by PDAT:
 - 1) hard copies of the Verkhovna Rada of Ukraine Resolutions #88/95-VR of 3/3/95, #334a/95-VR of 9/19/95, #542/96-VR of 11/22/96 and #205/98-VR of 3/24/98;
 - 2) hard copy of the Antimonopoly Committee Instruction #233of 9/10/97 including the amendments made by the Antimonopoly Committee during 1997-98;
 - 3) hard copy of the Cabinet of Ministers of Ukraine Resolutions #911 of 8/21/97.

4. Databases containing information on the results of sale of the state-owned share packages through tenders, stock exchanges and the PFTS. Database on the results of sale for the private shareholdings in privatized enterprises through the PFTS (secondary market).

The purpose of the databases CONTEST.mdb, UFB.mdb, PFTS.mdb.

- provide the Mass Privatization Project management and clients with consolidated PDAT reports on the results of all types of sale of the state-owned shareholdings;
- enable PDAT, MPP and the SPF to analyze the efficiency of various types of sale, monitor the general trends in the sale of OJSC shares by types of sale with the objective to draft proposals for the improvement and acceleration of the process of privatization;
- enable PDAT, MPP and the SPF to meet the needs of the clients by providing them with the most complete information on privatization;
- enable PDAT, MPP and the SPF to analyze the affect of state shareholdings sale over the development of the secondary market and the reverse;
- review and provide information for the correction of data in the SPF information search system "ETAP" and the SPF regular publications;
- maintain the analytical section of the SPF web-site.

Data accumulated and preserved by the PDAT members in CONTEST.mdb, UFB.mdb, PFTS.mdb

- soft copies of the official SPF publications prepared by the PDAT members on the following:
 - 1) the results of tender sale of enterprise share packages;
 - 2) the results of sale of enterprise share packages via the stock exchange network and the PFTS;
- PFTS data on the results of privatized enterprise share sale on the secondary market.

5. Industry-specific analytical databases for grain industry enterprise privatization (KHLEB.mdb) and energy sector (ENERGO.mdb)

Purpose of KHLEB.mdb and ENERGO.mdb databases

- provide all interested parties and potential investors with a maximum amount of the available information on the privatization status of the most attractive industries;
- enable PDAT, the Mass Privatization Project and the SPF to analyze and make forecasts as regard to the progress of privatization for the enterprises belonging to the strategically important industries;
- maintain the analytical section of the SPF web-site.

Data accumulated and preserved by the PDAT members in KHLEB.mdb and ENERGO.mdb databases

- databases generate standard reports using and consolidating information from other PDAT databases.

TECHNICAL DESIGN AND MAINTENANCE OF THE DATABASES

All databases are designed as programs operating in Access 2.0 and Windows 95 environment. UKRAINE.mdb database protected from any accidental changes is designed to facilitate an independent access by a wide circle of users. Other databases are not protected from changes, i.e. they are designed to be used internally, but any interested party may also obtain any information from them. A regular updating of the information contained in all databases may be performed by software professionals only with the assistance of PDAT analysts. Currently, the functioning and daily data accumulation in all databases is being performed by PDAT analysts and programmers.

UKRAINE.mdb

The system has been installed at the common-access Mass Privatization Project server as well as the SPF Certificate Privatization Department. Data are protected from an any undeliberate or deliberate modifications on the part of users.

- DIS_COL.MDB sub-system contains data on certificates issued to citizens (received in paper form from the Savings Bank and Oranta Insurance JSC on a monthly basis, manually entered into the sub-system and may be subsequently verified);
- WINNED.MDB sub-system contains data on the number of certificates accepted as payment;
- DATA00.MDB sub-system contains data on enterprises offered in PPC, CC and cash auctions (received from SPF ETAP-AUCTION database once in two weeks in an electronic format);
- AUC_UCCA.MDB sub-system contains data on certificate auction results (received from the UCCA after the approval of the SPF Order on the certificate auction results) used as a master copy of data;

- AUCTIONS.MDB sub-system - contains summarized bid information and the approved results of enterprise participation in PPC auctions (received from DATA00.MDB sub-system prior to the auction and from AUC_UCCA.MDB sub-system after the approval of its results); in the process of data import, the system ensures its verification, locate the discrepancies, and calculation of additional indicators not included in the SPF ETAP-AUCTION database, or the UCCA databases; the sub-system is also used as a data source for other bases;
- COMPENS.MDB and CASHSALE.mdb sub-systems contain summary data on bids received and the approved results of enterprise participation in CC and cash auctions, similar to AUCTIONS.MDB sub-system;
- CODES.MDB sub-system contains unified statistical codes used for processing the information available in all databases (tables containing standard Ministry of Statistics codes are supplied by the SPF IT Department; other codes are designed by PDAT itself for the internal use only).

Other databases

In view of the lack of any established requirements to the analyses and reports, the information is preserved in tables, and, if necessary, is processed upon a one-time request. The complete accessibility of data contained in databases prevents the unprepared users from taking advantage of the system. A regular modification and verification of data requires a permanent processing of data by persons responsible for designing and maintaining the databases.

“Ukraine Privatization and Investment” Web Site

- designed, maintained and managed for the State Property Fund by the PricewaterhouseCoopers/USAID MPP project team – exists primarily to disseminate information to a global audience about the principles, procedures and achievements of Ukraine’s privatization program. The web site (<http://www.ukrmassp.kiev.ua>) is maintained in Ukrainian and in English and has become a vehicle for the promotion of investment in Ukraine’s industry by providing privatization data and analyses to international and domestic investors. The web site is one of the few mechanisms by which the Government of Ukraine can transparently, rapidly and inexpensively provide information on privatization to market participants.

The site, the largest privatization web site in Ukraine, provides more than 15 megabytes of data on Ukraine's privatization program. Browsers may peruse all relevant privatization laws and regulations, explanations of the various methods of privatization, detailed data on the results of certificate (i.e., voucher) auctions, information on each of the 6500 medium and large enterprises which have sold shares in certificate auctions, analyses and data on strategic sectors and enterprises including the electric power industry and the agro-industrial sector, tender regulations, the list of all 9000 medium and large enterprises privatized to date, an analysis of the privatization status of Ukraine's 200 largest enterprises, and other information of interest to potential investors.

In particular, foreign and domestic investors alike may access data on strategic enterprises participating in cash tenders. The site highlights some of Ukraine’s largest and most attractive enterprises, including electricity generating companies. For select enterprises, readers will find a general description of the enterprise, its business activity, markets, environment, share allocation plan, investment projects, balance sheet and profit and loss accounts for the last 2 - 3 years.

The web site includes four major sections: (1) Ukraine’s Mass Privatization Program: Principles and Procedures; (2) Privatization of Ukraine’s Strategic Industries; (3) Statistics and Analysis; and (4) Selling the Crown Jewels: International Tenders.

Linked to all major world searching engines, the site is also broadly represented on the World Bank web site, PrivatizationLink. Recently the number of “hits” to the web site has exceeded 300 per day, making it one of the most popular Ukrainian web sites.

Following is the Table of Contents for the Web Site:

Table of Contents

Home Page – *UKRAINE PRIVATIZATION AND INVESTMENT WEB SITE*

◆ **The Mass Privatization Program: Principles and Procedures**

Big Picture: Why Mass Privatization?

Concept

Mass Privatization and Economic Reform in Ukraine

Nuts & Bolts: How Does the Program Work? Objects for Sale. Asset Valuation. Means of Payment. Methods of Sale. Sellers. Buyers. Intermediaries

Law on Large-Scale Privatization

Law of Ukraine on Business Associations

1998 State Privatization Program

List of enterprises planned for privatization in 1998

Ukraine's Privatization Program: Progress Report

◆ **Privatization of Ukraine's Strategic Industries**

Ukraine's "Strategic" Sector Privatization

Ukraine's "Top 200" Enterprises Analysis

Ukraine's "Top 200" Enterprises List

Electric Power

Electric Power Sector Privatization Program

Agro-Industry

Agro Industrial Complex Demonopolization and Privatization Weekly

Agro-Industry Privatization Program

Grain Sector Privatization Plan & Progress

Cabinet Resolution On Accelerating the Privatization of Grain Marketing and Distribution Enterprises (of November 5, 1997 # 1218)

◆ **Analyzing Progress: Statistics and Analyses**

Enterprises Privatized Since 1992
General Mass Privatization Statistics
Privatization Property Certificates (PPC)
Compensation Certificates (CC)
Enterprises Sold Through Certificate Auctions Since 1995
List of Auctioned Enterprises
Certificate Auctions Statistics
Privatization Property Certificate Auctions
Compensation Certificate Auctions
Cash Auction Statistics
Certificate Distribution

◆ **Selling the “Crown Jewels”: International Tenders**

Procedures

Tender for International Advisors (for the sale of strategic enterprises) Regulation
International Tender Regulation
Tender Announcements of the State Property Fund of Ukraine

INFORMATION SYSTEMS DEVELOPED FOR THE UKRAINIAN MASS PRIVATIZATION PROJECT

I. Information system for conducting and calculating Auctions for Property Privatization Certificates (PPCs)

The system was developed using DBMS FoxPro version 2.6 and comprises the following subsystems, which are explained in detail below:

- A. *AUCTION* - program for entering data from bids for certificate auction in the regional centers for certificate auctions (RCCA).
- B. *FI* - program for entering data of financial intermediaries (FIs)10.
- C. *DEPOSIT* - software for processing data from FI bids at RCCAs and the Ukrainian Center for Certificate Auctions (UCCA).
- D. *MASS_PR* - certificate auction calculation programs.

A. “*AUCTION*” subsystem for entering data from bids for certificate auction

Purpose: Created for entering data from bids for certificate auctions, their consolidation, review at Data entry centers (DEC), transfer of the information entered to the UCCA, receipt from the UCCA of auction calculation results and their print-out.

The primary clients of the system are RCCAs in 26 regions of Ukraine.

The subsystem Contains the following program modules:

- *setup* entering DEC parameters and auction parameters;
- *action* entering data from bids for certificate auction;
- *main* consolidating and verifying the data entered and the uniqueness of the the PPCs bid at a regional level;
- *package* packing and transferring to the UCCA the data entered via telecommunications or on diskettes, and receiving auction calculation results from the UCCA.

Minimal configuration and operation environment for the system:

Processor	80286 or higher
RAM	2 Mb
MS DOS version	3.3 or higher
Monitor	monochrome
Disk space	5 Mb free
Diskette	5.25 3.5

The system is currently running on the following types of servers:

Prosignea 300	(Windows NT)
Prosignea 500	(NetWare 3.12)
Prolinea 4/33	(NetWare 3.12)
Texas System	(NetWare 3.12)

Workstations (processor 80486):

Prolinea 4/33
IQ System
AST Bravo
Fountain

To run this system, every region uses one server, while the number of PC-workstations varies from 9 to 18 dependant on the data entry volume. The system is designed to work both on a stand-alone computer and in a network.

Each operator has access only to the needed data. The manager shall define personnel access rights according to functional duties.

The bids are entered in batches via double entry by two different operators. Bids entered with errors are marked accordingly and corrected until there is a complete match between the data entered. Batches of bids are considered ready to be transferred only if the double entry of each bid is correct.

The manager distributes bids batches, controls the process of bid entry, processes errors in bids, checks for completeness and integrity of the data entered, prepares data to be transferred and transfers information entered to the UCCA with the help of program options.

The system provides for information back-up. The user may view screen menus and prompts in Ukrainian or Russian.

B. “*FI*” - a program for entering data on financial intermediaries

Purpose: To enable FIs to enter data from investors’ documents, on behalf of whom the FI submits a bid for share purchase.

The primary clients of the system are financial intermediaries.

- The software, given freely to financial intermediaries, includes programs designed for data entry, control over the accuracy of data entry, editing the data, and copying the data to diskette for transfer to the RCCA.
- The software allows the creation of an appropriate batch on the hard drive for each batch of cash or non-cash certificates. Following data entry, review and approval, the system provides for the possibility to copy a batch onto a diskette to transfer it to the RCCA.
- If required, the program provides different security levels for user access to the data.
- Minimal configuration and operational environment of the system are the same as for the *AUCTION* system.

C. “*DEPOSIT*” software for processing data from FI bids at RCCAs and the UCCA

The system comprises two software modules designed to process FI data in the RCCA and the UCCA respectively.

The primary clients of the system are the RCCAs in 26 regions of Ukraine and the UCCA.

Purpose: The system serves:

- in the regions to receive information from FIs and review it, to perform reservation of PPCs according to FI bids, to transfer data to the UCCA and obtain auction results, to

create registries and logs for withdrawing certificates, and to perform regular revisions of the PPCs accounted for.

- in the UCCA to receive data of FI from the regions and to transfer auction results as per the FI bids to the regions.

Minimal configuration and operational environment for the system:

Processor	80386 or higher
RAM	2 Mb
MS DOS version	3.3 or higher
Monitor	EGA
Disk space	2 Mb free
Diskette	5.25 3.5

The system is currently running:

- in the regions - on one computer (Pentium or 80486 processor) or on two computers (80486 processor) and server (the kind of server is one of the listed above for AUCTION system),

- in the UCCA - on server Proliant 15000 (Novell NetWare version 3.12)

Processor	80486
RAM	32 Mb
disk space	8 Gb

and on workstation with

Processor	Pentium-100
RAM	32 Mb
disk space	8 Gb

The system was designed to work both on a stand-alone computer and in network.

Each operator has access only to the data he needs. The manager shall define personnel access rights according to functional duties.

D. *MASS_PR* certificate auction calculation program

Purpose: The system was designed to review the completeness and integrity of data obtained from the regions at the national level, process bids received from regional auction centers, perform the auction calculation, transfer the results to regions, and export auction information to the share owners database.

The system also contains software modules to provide statistical reporting about the auctions, and to check the uniqueness of PPCs bid for the auctions held throughout the country.

The primary client of this system is UCCA.

Minimal configuration and operational environment for the system:

Processor	80386 or higher
RAM	4 Mb
MS DOS version	3.3 or higher
Monitor	EGA
Disk space	10 Mb free
Diskette	5.25 3.5

The system is currently running on two servers: Proliant 15000 (Novell NetWare version 3.12) and HP LC (Novell NetWare version 4.11) with

Processors	80486 and Pentium-100
RAM	32 Mb and 64 Mb
disk space	each - 8 Gb, which serve as data storage;

and on two workstations with

Processors	Pentium-100 and Pentium-75
RAM	32 Mb and 16 Mb
disk space	8 Gb and 2 Gb.

The system provides for back up copying of auction information. Each operator has access only to the data he/she needs. The manager shall assign personnel access rights according to functional duties.

II. The system for conducting and calculating Specialized Certificate Auctions for Compensation Certificates

The system is developed using DBMS FoxPro version 2.6.

Comprises the following subsystems:

- A. *COMPENS* - a program for entering data from bids for specialized auction in the regional centers for certificate auctions (RCCA).
- B. *CCAUCT* - specialized auction calculation program.

A. *COMPENS* - the program for entering data

Purpose: Created for entering and consolidating data from bids, review at data entry centers (DEC), transferring the information to the UCCA and receiving from the UCCA of auction calculation results.

The primary clients of the system are RCCAs in 26 regions of Ukraine.

The program *contains* the following program modules:

- *setup* - to enter DEC parameters and auction parameters;
- *compens* - to enter data from bids for specialized auction itself;
- *rcca* - to consolidate and to verify the data entered;
- *package* - to pack and to transfer to the UCCA the data entered via communication means or on diskettes, and to receive from the UCCA auction calculation results.

The minimal configuration and operation environment for the system are the same as for the AUCTION system. The system is currently running in 26 regions on the same servers and workstations as the AUCTION system.

The system is designed to work both on a stand-alone computer and in a network. Each operator has access only to the data he/she needs. The manager assigns personnel access rights according to functional duties.

The bids are entered in batches via double entry by two different operators. Bids entered with errors are marked accordingly and corrected until there is a complete match between the data

entered. Batches of bids are considered ready to be transferred only when the double entry of each bid is correct.

The manager distributes bids batches, controls the process of bids entry, processes errors in bids, checks for completeness and integrity of the data entered, prepares data to be transferred and transfers information entered to the UCCA with the help of program options.

The system provides for information back-up.

B. *CCAUCT* - specialized auction calculation program

Purpose: The system is designed to review the completeness and integrity of data obtained from the regions at the national level, to process bids for specialized auctions received from regional auction centers, to perform auction calculations, to transfer the results to regions, and to export auction information to the share owners database.

The system also *contains* a software module to provide statistical reporting about the auctions.

The primary client of the system is the UCCA.

The minimal configuration and operational environment for the system are the same as in *MASS_PR* system. *The system is currently running* on the same servers and PC-workstations as *MASS_PR* system.

The system provides for back up copying of auction information.

Each operator has access only to the data he/she needs. The manager assigns personnel access rights according to functional duties.

III. The system for conducting and calculating specialized cash auctions

The system was developed using DBMS FoxPro version 2.6. and *consists* of the following subsystems:

- A. *CASHAUCT* - a program for entering data on bids for specialized cash auction in the regional centers (RCCA).
- B. *CCASH* - program of specialized cash auctions calculation in the UCCA.

A. *CASHAUCT software for data entering*

Purpose: Created for entering data from bids, the consolidation, review at data entry centers (DEC) of the RCCA cash auction departments, transfer of the information to the UCCA, receipt from the UCCA of auction calculation results, export of auctions results in electronic format for further transfer to issuers and RPFs.

The primary clients of the system are RCCA cash auction departments in 26 regions of Ukraine.

The software *Contains* the following program modules:

- *setup* - to enter DEC parameters and auction parameters;
- *cashaut* - to enter data from bids for specialized cash auction itself
- *rcash* - to consolidate and to verify the data entered; to print out and export auctions results in electronic format;
- *package* - to pack and to transfer to the UCCA the data entered and to receive auction results via communication means or on diskettes.

The minimum configuration and operation environment for the system are the same as for the *AUCTION* system. To run the system they use servers and workstations of the RCCAs departments for conduct of specialized cash auctions.

The system is designed to work both on a stand-alone computer and in a network. Each operator has access only to the data he needs. The manager assigns personnel access rights according to functional duties.

The bids are entered in batches via double entry by two different operators. Bids entered with errors are marked accordingly and corrected until there is a complete match between the data entered. Batches of bids are considered ready to be transferred only when the double entry of each bid is correct.

The manager distributes batches of bids, controls the process of bids entry, processes errors in bids, checks for completeness and integrity of the data entered, prepares data to be transferred and transfers information entered to the UCCA with the help of program options.

The system provides for information back-up.

The screen menus and messages may be, subject to operator's option, in Ukrainian or Russian.

B. *CCASH* - specialized auction calculation program

Purpose: The system is designed to review the completeness and integrity of data obtained from the regions at the national level, to process bids for specialized cash auctions received from regional

auction centers, to identify cash and bids collected by RCCAs, to perform the auction calculation, to transfer the results to regions, and to export auction information to the share owners database.

The system also *contains* a software module to provide statistical reporting about the specialized cash auctions. *The primary client* of the system is the UCCA Department of Preparation and Conduct of Specilaized Cash Auctions.

The minimal configuration and operational environment for the system are the same as in *MASS_PR* system.

The system provides for back up copying of auction information.

Each operator has access only to the data he needs. The manager assigns personnel access rights according to functional duties.

IV. The software package for closed subscription

The system was *developed* using DBMS FoxPro version 2.6. and includes the following subsystems:

- A. *CLOSESUB* - software allowing entry of closed subscription data on enterprises;
- B. *PREFSALE* - software for closed subscription data consolidation.

A. *CLOSESUB* software for entering closed subscription data on enterprises

Purpose: This system is designed for entering data from applications for purchasing shares during closed subscription, controlling the accuracy of data entry, editing the data, printing reports on closed subscription results for further approval, and recording the data entered on diskette for transfer to the UCCA.

The primary clients of the system are enterprises and RCCAs in 26 regions of Ukraine.

The minimal configuration and operation environment for the system are the same as for the *AUCTION* system. The system is currently running on the Pentium or 80486 processor computers. The number of workstations depends on the volume of data entry.

Each operator has access only to the data he/she needs. The manager assigns to personnel access rights according to their functional duties. The control of accuracy of data entry is performed via double entry of the data by another operator and automatic comparison of the results. Following data entry, review and approval, the system provides for closing the log and copying it onto diskette for transfer.

B. *PREFSALE* - software for closed subscription data consolidation at the RCCA and UCCA

This system includes two software modules designed for consolidation of closed subscription data at the regional and national levels at the RCCA and UCCA, respectively.

The primary clients of the system are RCCAs in 26 regions of Ukraine and UCCA.

Purpose: The system serves:

- in the regions to receive information on closed subscription by enterprise, to enter information on closed subscription results approval, to generate appropriate reports, to transfer data for registration in the share owners database, to obtain the results of registration in share owners database, to print extracts from the auction commission protocol.
- in the UCCA to receive data from the regions and to enter the closed subscription information into the share owners database, to transfer the results of closed subscription data registration in the share owners database to the regions.

The minimal configuration and operational environment for the system are the same as for *DEPOSIT* system.

The system is currently running in regions as well as in the UCCA on the Pentium or 80486 processor computer.

V. ENTPREP - the system for preparing enterprises documents for privatization

The system was developed using DBMS FoxPro version 2.6.

Purpose: ENTPREP is designed to allow the computerised preparation of enterprise documents for privatization.

The primary clients of the system are enterprises located in 26 regions of Ukraine.

The software allows the user to compile documents from standard data and standard text, entry and editing of the required additional information, and print all required documents. The document package contains: property valuation act, share allocation plan, statute, share issue resolution protocol, and share allocation information.

The minimal configuration and operational environment for the system are the same as for the AUCTION system.

VI. Shareholders Database Information System

The *system* contains two software modules described below:

- A. *SHAREHOLDERS DATABASE* software for share owners database
- B. *TRANSFER* software for entering data on share ownership rights and for making changes to the data on shareholders.

A. SHAREHOLDERS DATABASE software

The system is developed based upon a Compaq Proliant platform with the SCO OPEN SERVER 5.0 Operation System, and the database server INFORMIX OnLine 7.1. The server and client parts of the system were developed in SPL SQL language and JAM 6.1 for Windows 95 development tool.

Purpose: To identify share owners, record the number of shares to which registered persons are entitled by the various auction processes, keep data on shareholders, provide interested persons and state controlling bodies access to system data within established limits.

The primary client of the system is the UCCAs main department for maintaining the shareholder database.

The minimal configuration and operational environment of the system:

Server part:

Processor	UNIX-server Compaq Proliant
RAM	not less than 32 Mb
HDD space	not less than 40 Gb
operation system	SCO OPEN SERVER 5.0
DBMS INFORMIX OnLine 7.1	

Client part:

Processor	80486 or higher
RAM	Minimum 16 Mb

Operation system	Windows 3.1/ Windows 95
Monitor	VGA/SVGA
HDD space	Minimum 250 Mb

The system is currently running on the server Compaq Proliant with:

Processor	Pentium-100
RAM	64 Mb
HDD space	40 Gb

and on four PC-workstations Folgat with:

Processor	each 80486
RAM	each 16 Mb
HDD space	three with 420 Mb each and one with 2 Gb

Shareholders Database the list of shareholders compiled as of any date, allowing the identification of owners, the number of shares owned, and information on issuers and share issues.

The system enables the user:

- to upload certificate auctions results, specialized CC auctions results and closed subscription data,
- to create lists of uploaded enterprises as per auction results and lists of uploaded auctions by enterprises,
- to export in an agreed format information on share owners of privatized enterprises according to certificate and specialized auctions results,
- to create audit reports on exported data,
- to provide reference-type information on all data contained in the shareholder database, and
- to review PPC numbers to prevent the possibility of their repeated utilization and to generate a report on the results of such a review.

Back-up copies are created automatically. Each operator has access only to the data he/she needs. The manager can assign personnel access rights according to functional duties.

B. *TRANSFER* - the software for transactions data entry

Purpose: To enter data from applications related to share ownership rights transfer (transfer orders) and changes to shareholder data (changes orders), to review at data entry departments (DED), and to transfer the information to the shareholder database.

##

The primary clients of the system are RCCAs in 26 regions of Ukraine.

Contains the following software modules:

- *setup* - to enter DED parameters and auction parameters;
- *transfer* - to enter data from orders;
- *package* - to pack and to transfer to the shareholder database, and to receive the results of registration in the share owners database.

The minimal configuration and operation environment are the same as for the *AUCTION* program.

The system is designed to work both on a stand-alone computer and in a network. Each operator has access only to the data he needs. The manager assigns to personnel access rights according to functional duties.

The orders are entered in batches using double entry by two different operators. Orders entered with errors are marked accordingly and corrected until there is a complete match between the data entered. Batches of orders are considered ready to be transferred only when the double entry of each order is correct.

The manager distributes batches of orders, controls the process of batch entry, processes errors in orders, checks for completeness and integrity of the data entered, prepares data to be transferred and transfers information entered to the share owners database with the help of program options.

The system provides for information back-up.

VII. The telecommunication system for auction data transfer

Purpose: The telecommunication system enables:

- data transfer between RCCA and UCCA,
- protection of data from unauthorised access (data ciphering, server resources access rights),
- automation of processes of preparing the data to transfer (archiving, ciphering),
- transfer and receipt of the data, and
- processing of the data received (deciphering and decompressing).

The system comprises the following subsystems:

- A. *SERVER* a telecommunication utility for the UCCA
- B. *NODE* a telecommunication utility for the RCCA

A. *SERVER* - telecommunication utility for the UCCA

The system was developed using Delphi version 2.0.

The primary client of the system is UCCA.

Purpose: To prepare data for transfer and to process data upon its receipt, the data may be transferred or received on diskettes (if necessary).

The minimal PC configuration and the environment is as follows:

Processor	80486
RAM	8 Mb (depends upon operation system requirements)
Version of MS Windows	Windows 95, Windows NT
HDD space	free 3 Mb
Monitor	monochrome

The system is currently running on the server Compaq Prosignea 486(Windows NT)
RAM 32 Mb

HDD space	1 Gb
Digiboard	16 COM ports Host Adapter

RCCA data can be received and auctions results can be transferred by the system via:

- ordinary telephone lines or Iskra lines by 3 modems ZyXEL U-1496 Plus;
- UkrPak digital channels and Router CISCO 2509;
- satellite station Intelsat PES6000IFM and Router CISCO 2509;
- leased line connection by modem PATTON model 1004;
- diskettes.

The system is designed to work both on a stand-alone computer and in a network. System resources access shall be defined by the system administrator.

Data to be transferred (parcels) are formed by external systems or a program.

Each parcel is prepared, transferred and processed as a separate logical entity.

Operator manages processes and obtains necessary reports on the system condition via program options.

B. *NODE* - RCCA telecommunication utilities

The system is developed using Borland Pascal version 7.0.

The primary clients of the system are RCCAs in 26 regions of Ukraine.

The utilities *comprise* the following modules:

- *Setup* - to change telecommunication system parameters
- *Node* - to prepare data for transfer and process data received, to transfer and receive data via ordinary telephone lines, Iskra lines, UkrPak digital channels, sputnik systems or diskettes.

The minimal PC configuration and operational environment:

Processor	80386
RAM	2 Mb
MS DOS version	3.3
Disk space	free 3 Mb (including MS RAS and FTP Software Clients)
Monitor	monochrome

The system is currently running in every region on workstations with 80486 processors and transfers data to the UCCA on ZyXEL U-1496 Plus modems. Six regions have telecommunication satellite stations Intelsat PES6000IFM.

The system is designed to work both on a stand-alone computer and in a network.

Only the telecommunication system operator has access rights to the program.

Packages of data for transfer (parcels) are formed by external systems or from the program. Each parcel is prepared, transferred and processed separately as logically integral. The operator manages processes via program options. Each RCCA has its own system resource at the UCCA telecommunication server.

Software User Manuals Developed

<u>Name</u>	<u>Software</u>
1. Data entry procedures manual for regional centers for certificate auctions	Setup, Auction, Package (system AUCTION)
2. Brief manual for data center procedures	Main (system AUCTION)
3. Instruction on software package for regional centers for certificate auctions	System AUCTION
4. Financial Intermediaries data entry software manual	System FI
5. Manual on software for work with Financial Intermediaries	System DEPOSIT for RCCA
6. FI software manual for the UCCA	System DEPOSIT for UCCA
7. Manual on procedures for the data center of the UCCA	System MASS_PR
8. Instruction on software interaction while conducting certificate auctions at the UCCA	Interaction of system DEPOSIT for UCCA and MASS_PR
9. Compensation certificates auctions software manual for RCCA	Setup, Compens, Package (system COMPENS)
10. Automated system for specialized CC auctions. (UCCA software manual)	System CCAUCT
11. A manual on the procedures for data entry for specialized cash auctions	Setup, Cashaut, Package (CASHAUCT system)
12. Brief guide to procedures to be used by data specialists of RCCAs responsible for specialized cash auctions	Rcash (CASHAUCT system)
13. A software guide for the UCCA department responsible for specialized cash auctions	CCASH system
14. Data entry software manual (for entering closed subscription bid details).	System CLOSESUB
15. Manual for closed subscription data processing at the RCCA	System PREFSALE for RCCA
16. Manual for closed subscription data processing at the UCCA	System PREFSALE for UCCA
17. Users manual on the system for preparing enterprise documents to privatization	System ENTPREP
18. Shareholder database data entry procedures	System TRANSFER
19. Shareholder database maintaining procedures	System SHAREHOLDERS DATABASE*
20. Instructions for NODE telecommunication system installation	System NODE
21. Telecommunication system software manual. Brief operation guidance for NODE communication utilities	System NODE
22. Telecommunication server software. A review of functions.	System SERVER

New versions of each software are accompanied by an instruction-letter for users in all RCCAs or the UCCA describing changes in the system and the appropriate procedures.

MASS PRIVATIZATION AUDIT PROJECT: SUMMARY OF THE FINAL REPORT

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Priority Tasks/Work Requirements

Representatives from the Price Waterhouse (PW) Audit and Business Advisory Services Group (ABS) were an integral part of the Ukraine Mass Privatization Project (UMPP) from 1994 through 1998 under four separate United States Agency for International Development (USAID)/PW Task Orders beginning and ending on the following dates: November 1, 1994 - August 3, 1995, August 4, 1995 - August 14, 1996, August 15, 1996 - April 14, 1997, and April 15, 1997 - May 31, 1998. PW ABS were engaged within the Task Orders mentioned above to provide assistance with ensuring the transparency of the certificate auction process. Based upon PW ABS's strategic plan, our main goals were broadly and primarily to:

- 1) Provide assistance to promote the integrity, transparency and efficiency of Mass Privatization (MP) through performing well planned procedures within the Auction Center Network (ACN), and based upon specific requests from counterparts other than those tasks stated as primary for the audit function in related Task Orders (State Property Fund of Ukraine, or SPFU, and the Ukrainian Center for Certificate Auctions, or UCCA).
- 2) Provide practical support and consultation externally to UMPP counterparts in accordance with Task Order Requirements and based upon specific requests from USAID.
- 3) Provide the SPF with technical knowledge through training and hands on experience as well as the motivation to adequately take over the control function within MP by the end of UMPP.
- 4) Provide suggestions/recommendations to counterparts during procedures performed within the ACN regarding controls as well as regarding management of staff, budgeting/analyzing/reporting on expenditures, and other areas which will increase the efficiency and effectiveness of the ACN. Provide training to UCCA staff in monitoring the auction process.
- 5) Provide continuous task progress updates to internal parties and interested external parties (USAID) and related counterparts regarding training, joint audits and progress of other tasks.

Primary Objectives

Although PW ABS was responsible for various tasks within the USAID Task Orders (see above) related to UMPP, there were five main areas in which PW ABS had primary tasks from 1995 - May 1998:

- Training of counterparts in Western audit methodology;
- Joint audit visits with counterparts (UCCA, SPF) within the ACN;
- Audit Visits to RCCAs and reporting of findings and recommendations;
- Assistance with procedural design and audit issues within the regulatory framework of auction processes;
- Monitoring of USAID financing and inventorying of USAID property utilized by the ACN (including Revision Commission work detailed in the following section).

Primary Accomplishments

- Training manual detailing Western audit principles, application of audit principles within the ACN, and reporting of work performed.
- Training of UCCA and Regional Property Fund (RPF) counterparts in Western audit principles.
- Joint audit schedule with UCCA during 1997 and 1998.
- Joint audit visit with SPF to Kherson RCCA in 1998.
- 89 visits within the ACN to perform audit procedures.
- Monitoring of financing and implementation of controls surrounding the receipt and use of USAID funding on a regular basis.
- Issuance of Revision Commission Report during 1996 jointly with SPF and UCCA Commission members.
- Assistance with controls and/or procedures regarding monitoring the transparency of the following processes: distribution of privatization certificates, safekeeping of privatization certificates,

maintenance and safekeeping of USAID property within the ACN, transfer of share registry information, cash sales, and post privatization certificate distribution.

- Work with other UMPP departments and with external parties involved in privatization.

TRAINING MANUAL. Prepared a detailed training manual designed for use in seminars for and in skills transfer to the UCCA and SPF, and for internal PW UMPP staff training. The manual includes three major parts: International audit principles (theoretical framework), application of these principles to the ACN, and audit reporting principles. The audit theory section covers the following spheres: types of audits, risk-based approach to the audit (planning and execution of the audit), types of audit procedures performed during the execution phase, and final procedures during completion of the audit process. The ACN section includes presentation of the auction-orientated audit programs, explanation of specific procedures performed, specific risks within the auction process and related controls which can reduce such risks. The reporting section details the purpose, general principles and objectives of reporting, and areas generally covered in the Audit Report of Findings.

UCCA/SPF TRAINING - PW ABS planned and conducted four audit training seminars utilizing the audit training manual discussed above as the framework. The first seminar was given in conjunction with an SPF seminar and included RPF Extra Budget Fund Representatives (conducted in 10/96). The second seminar was a three day seminar given solely by PW to Regional Center for Certificate Auction (RCCA) representatives of the Chief Accounting Departments and to UCCA Control Department representatives (12/96). The third seminar was a two day seminar given for SPF Control Department Representatives and was also presented using the training manual prepared by PW (12/96). The fourth seminar included more detailed information about Western audit and accounting principles and included a reporting section (2/98).

Further SPF training in 1997 never materialized, although proposals from PW were drafted and delivered to a number of individuals within the SPF. Additionally, assistance was offered to the SPF Control Department regarding establishing a solid reporting structure from the ACN to the SPF and to the GOU, as well as Revision Commission follow up work. The SPF was not receptive to our attempts at assistance during 1997 and 1998. Training proposals created were sent to more than five people in high level management positions within the SPF beginning in 1997, and were copied to USAID. During the first quarter of 1998, a letter on behalf of USAID was drafted by PW and sent to USAID concerning SPF inability to attend training during 1997 and 1998, despite the Task Order agreement.

JOINT AUDIT SCHEDULE WITH UCCA DURING 1997 AND 1998. The UMPP ABS group began conducting joint RCCA audit visits with representatives of the UCCA Coordination Department in 1997 after reaching an agreement with the UCCA after 2 years of attempted coordination. As of May 31, 1998, fourteen joint audit visits had been performed in the following regions:

Ivano-Frankivsk	Jan. 14 - Jan. 17, 1997
Zakarpattya	Jan. 27 - Jan. 31, 1997
Vinnitsa	Aug. 18 - Aug. 22, 1997
Dnipropetrovsk	Sep. 1 - Sep. 5, 1997
Chernivtsi	Feb. 3 - Feb. 7, 1997
Kherson	Feb. 6 - Mar. 1, 1997
Lviv	Feb. 26 - Mar. 1, 1997
Khmelnysky	Mar. 3 - Mar. 7, 1997
Volyn	Oct. 13 - Oct. 18, 1997
Poltava	Oct. 27 - Oct. 31, 1997
Donetsk	Nov. 10 - Nov. 14, 1997
Sumy	Nov. 17 - Nov. 21, 1997
Kharkiv	Jun. 2 - Jun. 7, 1997

Odessa	Jun. 30 - Jul. 5, 1997
Sevastopol	Jul. 7 - Jul. 12, 1997
Lugansk	Aug. 4 - Aug. 8, 1997
Zaporozhie	Dec. 8 - Dec. 12, 1997
Simpheropol	Dec. 22 - Dec. 26, 1997
Ternopil	Jan. 19 - Jan. 23, 1998
Kherson	Feb. 1 - Feb. 4, 1998

During these audit visits, our primary goal was to transfer general knowledge about international auditing along with practical skills necessary for performing western audit procedures. During joint audit visits, PW ABS introduced to UCCA representatives the RCCA audit program, checklists and other materials which are used by PW ABS during RCCA audit visits. However, UCCA representatives were not always willing to participate as members of the team during fieldwork, and in some cases worked alone in particular areas in which the UCCA had given them specific tasks. This indicated the misunderstanding of the UCCA officials as to the role and main priorities of the joint audit visits. Nevertheless, during the last several joint audit trips, UCCA representatives expressed interest in the PW ABS audit methodology within the ACN. As a result, there was great interest and participation by UCCA representatives during the fourth training seminar given by PW ABS for UCCA counterparts.

89 AUDIT VISITS WITHIN THE ACN. Since mid 1995, UMPP ABS completed 89 visits within the ACN, including: three visits to the UCCA and 18 separate visits to Bid Reception Sites (BRSs) in the Kiev, Zhitomir, Cherkassy and Chernigiv regions of Ukraine. On average, each year there were 29 audit trips; each RCCA, in total, was visited two times, the majority of RCCAs were visited three times, and two RCCAs (Kherson and Donetsk oblasts) were visited a total of four times. Those RCCAs which did not fully implement PW recommendations and those with large transactions each year, were selected to be visited a third and fourth time. The overall goals of these audit visits, procedures performed and results of the audit visits are described in more detail in the section of this report entitled “Summary Overview: Results of Procedures Performed within the ACN” on pages 6 through 9 of this report.

It is important to mention that in subsequent audit visits in *many* RCCAs we noted improvement in the area of compliance with regulations and adequate procedures to safeguard certificates and equipment. Additionally, we received feedback from PW UMPP regional staff in the regions in April of 1996 regarding the PW Audit team’s contribution to the efficiency and transparency of the ACN operations. The PW Regional Consultants submitted audit follow-up reports which indicated that the Audit team increased the effectiveness of the ACN operations, our recommendations were seriously considered by RCCAs, and, in most cases, fully implemented subsequent to our audit visits.

Specifically, Regional Consultants noted the following with regard to RCCA visits performed at the time: 1) the Ukrainian version of the audit reports were distributed among RCCA management; implementation of findings were discussed, 2) RCCAs were familiar with the audit findings and related recommendations, 3) the majority of findings were accepted as the best practice for the RCCA; RCCAs suggested better practices for 10 recommendations out of approximately 150 audit findings and recommendations given by PW Audit, 4) RCCAs implemented the majority of recommendations within a week after the audit visit, 5) RCCAs appeared to have thought through our recommendations for those findings which were not implemented, and had specific reasons for not implementing our findings which they deemed to be adequate.

Revision Commission Work. The Revision Commission (the Commission) was formed as a UCCA management body to provide 1) control over financial activities of the UCCA and RCCAs, 2) control over the utilization of financial or technical assistance provided to the UCCA and RCCA, and 3) substantiated recommendations to the Board of the UCCA as to the improvement of reporting and accounting in activities of the UCCA and RCCA. As a member of the Commission in 1996, PW ABS in association with the Commission obtained previously confidential information from the SPF to analyze the expenditure of funds provided to the UCCA and RCCAs from the Extra Budget Fund (EBF). We used this information to evaluate the effectiveness of overall funding within the ACN, including funding from USAID for the first two quarters of 1996. The commission issued a report addressing findings (SPF, UCCA and PW members jointly prepared the report) and suggested recommendations for improving procedures and controls regarding financing within the ACN. Note that these findings ultimately led to the introduction of a new structure for USAID financing proposed by PW.

TRANSPARENCY CONTROL AND PROCEDURES. In addition to performing audit procedures in the UCCA, RCCAs and related agencies, PW ABS was involved in designing procedures for monitoring the auction process and in developing controls to maintain the transparency of aspects of the privatization process, such as:

- ***Savings Bank audit procedures.*** At the beginning of privatization certificate distribution to citizens of Ukraine by the Savings Bank, PW ABS conducted audit procedures in several oblasts of Ukraine to ensure that all necessary distribution and accounting procedures were adhered to in the Savings Bank branches. The Audit Team coordinated procedures and met with Savings Bank representatives to discuss these procedures. The main objective of PW ABS audit visits and resulting reports was to confirm that distribution was fair and efficient, to assess compliance with the Regulation on the Procedure of Distributing Privatization Certificates as approved by the National Bank of Ukraine, and to ensure that safekeeping of certificates was adequate. To add value within our audit visits, the audit team noted and discussed the low level of certificate distribution with regional personnel and attempted to determine solutions to improve the situation. Approximately 14 branches of the Savings Bank were visited by PW during 1995.
- ***Safekeeping of certificates within the ACN system.*** We developed vault log procedures to accompany regulations and test count procedures/reconciliation procedures in an effort to safeguard certificates within the ACN. The vault log details cumulative balances of certificates in the vault and test count/reconciliation procedures serve to verify this balance and guard against misappropriation of certificates. More details on this issue are described in the section entitled, "Summary Overview: Results of Procedures Performed within the ACN".
- ***Inventoring of and reporting on USAID property utilized by the ACN.*** The PW ABS team developed equipment accounting procedures and equipment test count/reconciliation procedures. A portion of each audit visit was devoted to conducting physical test counts of equipment provided by USAID/PW for the RCCA. PW drafted an inventory log which details equipment information maintained by each RCCA and developed test count/reconciliation procedures for monitoring and safeguarding equipment within RCCAs. By utilizing these procedures, RCCA's could maintain complete and accurate records of equipment received from USAID/PW as well as properly use and safeguard this equipment.
- ***Shareholder database/registry procedures.*** We summarized risks involved in the process and made recommendations for controls within the ACN related to the transfer of shareholder registry information to and from various privatization bodies.
- ***Mass cash sales.*** The PW ABS group assisted in the design of mass cash sales procedures through performing an analysis of draft cash sales procedures from an audit perspective. Primary risk areas were identified and recommendations proposed for informational purposes for the UMPP Policy team. We also participated in meetings with representatives of parties involved in designing cash sales procedures: the SPF, UCCA, Savings Bank of Ukraine and other banking institutions.
- ***ACN Financing Procedures (post USAID financing period).*** PW ABS prepared recommended controls and procedures to be used by the SPF and UCCA in implementing the SPF/UCCA Financing Agreement. These recommendations were given in an effort to transfer knowledge concerning financing related procedures, risks and controls within financing procedures, and budgeting/reporting of financial operations

within the ACN. Recommendations were based upon 1996 Revision Commission recommendations and PW procedures for financing the ACN with USAID-provided funding.

- ***Post certificate distribution audit procedures and guidance.*** We also drafted the main principles and procedures to be used in designing post-distribution PPC (Privatization Property Certificate) & CC (Compensation Certificate) destruction procedures and monitoring of the process. PW ABS designed the Post PPC & CC audit program which could be used by the Savings Bank of Ukraine, the SPF and the UCCA to enhance the transparency of this process.

ASSISTANCE TO OTHER UMPP DEPARTMENTS AND TO EXTERNAL PARTIES INVOLVED IN PRIVATIZATION. During its three and one half years of MPP work, PW ABS assisted other departments in completing tasks for which we could provide particular skills and experience. For example, we assisted the UMPP Finance Department in creating the imprest accounting system and procedures for financing the ACN with USAID funding and with implementation of procedural controls; assisted the Capital Markets Monitoring Unit in 1995 with drafting procedures detailing disclosure and reporting guidelines for investment funds and trust companies; assisted the Enterprise Preparation Department in working with the SPF to prepare enterprises for privatization.

PW ABS also assisted external parties, other than our primary counterparts, in the development of accounting procedures. In June of 1995, we assisted the Savings Bank in preparing documents which enabled it to reconcile certificate distribution data in an efficient manner; in July of 1996, we assisted the International Finance Corporation (IFC) concerning development of audit procedures for enterprises participating in the preparation process.

Primary Obstacles and Lessons learned:

I. Joint Audits with SPF: Timing of audit visits, staff availability, reporting requirements for SPF, counterpart costs for travelling.

Response: Attempted to maintain close contact with control department representatives to discuss/plan joint audits; attempted to utilize Memorandum Of Understanding (MOU) and joint work plan to leverage positive response from SPF; planned joint audits during convenient times for staff within SPF Control Department; utilized “user friendly” training materials which the SPF could use as a guide to perform audits and prepare related reports easily and efficiently. Worked closely with the PW UMPP Policy Department to gain support of SPF management.

II. Training of UCCA and SPF Staff: Timing of training, staff availability, management agreement, management understanding of necessity for and importance of training, counterpart costs for travel.

Response: Investigated Center for Privatization funding, Mass Privatization funding, coordinated with counterparts to utilize their premises for training, attempted to utilize trips to perform audit procedures in regions to train regional representatives (large regions), scheduled meetings with representatives to obtain consensus for timing of training, prepared training timetable during “slow periods” when counterpart staff would be available, leveraged PW liaison with related counterparts.

III. Audit Visits Within ACN: Right to perform audit visits must be secured with SPF, and access to accounting records and other information should be obtained from SPF and UCCA.

Response: Promoted good relationship and close contact with UCCA and SPF Control Department Representatives. Worked closely with PW UCCA representative in gaining support from UCCA, used MOU to obtain all necessary accounting information, ensured confidentiality of information through discussions with management of the UCCA.

IV. Introduction of New Regulations : i.e. related to the introduction of Compensation Certificates (CCs) and Housing Checks, post PPC/CC distribution, share registry procedures, procedures for Financial Intermediaries (FIs).

Response: Worked closely with PW UMPP Policy Department, identified risks and recommended controls early in the process of developing regulations, drafted audit programs in consultation with PW UMPP colleagues, “interpreted” regulations for ACN staff during regional visits.

V. Confidentiality of Information: Access to information may be denied by UCCA and or RCCAs.

Response: Sought to utilize MOU which states that the SPF should assist PW in gaining access to necessary information; obtained access letter from SPF prior to entering RCCAs/UCCA; attempted to utilize management representation letter tailored to the task at hand; planned and utilized alternative audit procedures in the case that necessary information was not presented to PW.

VI. Performance Based Financing Implementation/Reporting and Distribution of Funds by the UCCA: UCCA may not act in accordance with financing agreement; RCCAs may not act in accordance with the financing agreement or Ukrainian legislation; financing may not be distributed properly within RCCAs.

Response: Attempted to utilize management representation letter, utilized RCCA visits and BRS visits to perform internal inspections, assisted in implementing strict control structure over ACN financing, performed monthly procedures to determine that information sent from the UCCA was in accordance with the financing agreement, attempted to assist SPF in budgeting/reporting and analysis of budget to actual financial information; attempted to communicate continually with UCCA to determine issues early and respond appropriately.

Summary Overview: Results of Procedures Performed within the ACN

Summary of Results:

It is important to note that PW performed procedures regarding compliance with existing regulations as well as procedures to enhance internal controls within the ACN. As such, a list of regulations related to the functioning of the ACN is included as Appendix I to this report. For summary audit findings from July, 1995 - May 31, 1998, see Appendices III and IV.

During our audit visits, we also performed informal inspections and made operational observations in an effort to improve the efficiency and effectiveness of the ACN. We also noted the political, social and economic conditions surrounding RCCAs. Some general conclusions drawn and considerations made from results of procedures performed and communications with ACN employees are listed below:

External to the ACN

1. Government Policies and Changing Legislation

For many RCCAs, it was difficult to maintain a high level of quality work due to constant changes in privatization policies and legislative and regulatory changes. Problems within the ACN were increased due to the government's resulting lack of clear privatization planning and poor communication within the ACN.

2. Implementation of New Regulations/Procedures

RCCAs faced difficulties when attempting to implement details of new regulations (i.e. introduction of compensation certificates and requirements for Financial Intermediaries; see Appendices III and IV). Regulations contained a large volume of procedural information, the details of which were not always presented in an unambiguous manner. PW ABS attempted to assist with implementation of new regulations when in the regions performing audit visits. We assisted by presenting and explaining the new procedures as well as offering reasons for procedural controls within the regulations, where applicable.

3. Lack of SPF Planning

Lack of central bodies' (SPF and UCCA) auction planning significantly influenced the auction process. During the privatization process, the PW UMPP Enterprise Preparation Department consistently noted that the SPF did not maintain an adequate monthly planning device for the sale of state owned enterprises, particularly sales through the auction process. We noted evidence during our audit visits which suggests that this poor planning adversely affected the operations and the controls within the ACN. For instance, we noted in many cases that the UCCA and RCCA managements were unable to properly allocate human resources, and thus funds, efficiently within the auction centers; some employees were overutilized and some were underutilized at different points during auction periods. We noted large numbers of uncanceled certificates (after the results of auctions had been issued) stored in less than adequate conditions in some centers due to the high volume of certificate invested and inadequate staff resources to perform related work.

4. Limited Monitoring by the SPF and UCCA of ACN Activity

There seemed to be little motivation by managements of the SPF and UCCA to expand the current role of the Control Departments in each organization in monitoring ACN activity and performing audit visits within the ACN. After continued efforts over a two year period, the Audit Team conducted several joint audits with UCCA representatives in 1997 and 1998, and one with the SPF Control and Revision Department in 1998. However, the results of these joint audit visits were less fruitful than PW had hoped they would be.

We encountered difficulty early in the joint audit period when we attempted to actively train UCCA representatives in Western audit methodology, including risks and controls in the process, from our experience in performing procedures within the ACN. UCCA representatives tended to work separately during these audit visits in areas including UCCA Financing, RCCA Payroll, and other areas specified by UCCA management. UCCA representatives never endeavored to perform a detailed investigation of RCCA performance for improvement of operations and/or in procedural controls. We did note, however, during the final audit visits (especially during the audit visit which was performed with UCCA and SPF representatives), that UCCA representatives expressed a greater interest in PW ABS audit materials and audit methodology.

Internal within the ACN

5. Lack of Communication between Central and Local ACN Bodies

As mentioned previously, during the auction process, there were constant changes in the related legislative and regulatory framework, sometimes accompanied with new procedural instructions. During our audit visits, we noticed continually the lack of communication between the central and regional institutions of the ACN regarding introduction of new regulations, details of pending regulations, and assistance with implementation of existing procedures within the regulatory framework. In many cases, information detailing changes and/or amendments to regulations were communicated to regions late; in some cases the information was not communicated to regions at all.

6. Lack of Communication between RCCAs

Although the regulatory environment surrounding the ACN has been constantly changing, many areas of the auction process were not covered or were poorly presented in such regulations. In this respect, the practical experience of a particular RCCA in a procedural area could have been of significant importance and usefulness to other RCCAs in implementation of these regulations. However, lack of communication among RCCAs concerning experience in implementation of procedures resulted in repetition of similar problems and errors in many RCCAs (see Appendices III and IV for examples). This indicates that it would have been useful for the SPF and UCCA to create an efficient communication system among RCCAs. We attempted to share knowledge as much as possible during our audit visits as the Audit Team was in a prime position to gather information about the operations of many RCCAs.

7. Staff Recruitment and Utilization

Several RCCAs did not maintain an efficient staff recruiting and utilization policy. In some cases, we noted that ACN staff did not understand or were unaware of the importance of following the regulatory and legislative framework. Additionally, some employees were not performing work which was most efficient and effective for the RCCA. During the course of the audit work we attempted to investigate such issues, explain the situation to the RCCA management and give appropriate recommendations for more efficient utilization of employees.

8. Management Skills

Some of the issues discussed in this section may have arisen due to lack of extensive training of UCCA and RCCA managers in management and organizational skills, both of which become vital in a permanently changing, unstable political and economic environment. As detailed below, lack of such skills in conjunction with lack of planning by the SPF and UCCA, may have adversely affected the operations of the ACN.

9. Cancellation of Certificates

We noted major problems throughout the ACN regarding the cancellation of certificates (controls against misappropriation of certificates) stored within auction centers. Most problems were a result of issues discussed in numbers 3, 6 and 7 above. Additionally, vague procedural instructions in regulations and inadequacies within certain regulations, coupled with little communication within the ACN added to problems with cancellation and proper storage of certificates. Examples of such issues are included below:

- *Procedures for "Permissions"* - "Permissions" are issued to bidders when the object of privatization for which they bid is subsequently removed from the auction for specific reasons. "Permissions" allow these bidders to bid a second time for a different enterprise with the same certificate. At the beginning of the auction process, there were no specific regulations or procedures designed to facilitate this process. When a regulation was issued describing these procedures in 1997, external communication problems appeared; although RCCAs were aware of the new procedures in this regulation, the servicing bank in some regions were unaware of their role in this process. This resulted in RCCAs modifying procedures to comply with bank requirements, as opposed to regulatory requirements, in an effort to facilitate the process.

- *Accounting for “Permissions”* - as regulations did not detail specific procedures for accounting for permissions, many RCCAs improperly accounted for Permissions or did not account for Permissions at all. The PW Audit Team, during each audit visit, assisted RCCA employees in creating and following accounting procedures for Permissions.
- *Financial Intermediary (FI) Certificate Deposits* - with the beginning of PPC auction #17, FIs were required to deposit PPCs in the related RCCA prior to submitting an application and bid for participation in an auction. This requirement resulted in a large volume of PPCs being stored in RCCA vaults for lengthy and, sometimes, indeterminate amounts of time. Additionally, very often these PPCs were not cancelled after being bid or were cancelled incompletely. In many cases, RCCAs did not perform cancellation procedures due to lack of human resources, time or other issues.
- *Certificate Storage Facilities* - in the early stages of the auction program, many RCCAs did not have appropriate storage facilities for certificates; many storage facilities which did exist within RCCAs were not appropriate to guard against theft of certificates.

The above issues strongly suggest that a paperless privatization system may have been a better alternative to a “certificate based” system from a procedural and control vantage point.

It is important to mention that, although we noted many issues within the ACN as detailed in this section, the majority of RCCAs after audit recommendations had been issued significantly increased the strength of their internal control systems and management techniques. The main point which should be made here is that the improvement of the internal control system is the responsibility of each RCCA management along with the UCCA and SPF authorities. Significant improvements in the overall efficiency of and controls within the auction process were made only in those centers in which RCCA management were open to implementing our recommendations regarding procedural controls.

Beyond May 31, 1998

Some final thoughts follow concerning maintaining the transparency within the Mass Privatization process subsequent to May 31, 1998. Transparency and integrity of the process can be effectively maintained by the SPF should they put this goal as a top priority and make a strong commitment by allocating the resources and time necessary to accomplish this goal.

- I. ***Reporting within the Auction Center Network (particularly regarding financing) and to External Parties.*** Reporting within the ACN and to the SPF is a function which is fundamental to the success of the privatization process for planning, budgeting, revision, and control purposes. It is within this area that we believe the SPF should concentrate going forward and make a priority within the overall planning and monitoring process.
- II. ***Control and Revision Department of State Property Fund and Regional Property Funds and the UCCA.*** Based upon our experience within the auction network and dealings with the State Property Fund, we believe that the Control Departments of the UCCA and SPF, including RPFs, can and should be better utilized to monitor the privatization process. They may also serve to unite the ACN process by providing not only an invaluable monitoring instrument for the privatization process, but also by increasing the communication lines within the ACN and between the UCCA and SPF. This will facilitate standardization of practices within the ACN and will promote efficiency and transparency within the process.
- III. ***Government of Ukraine (GOU) Accounting Body.*** Although the role of this body within the process remains unclear, we believe that the GOU should increase the appearance and substance of standard setting and monitoring of the SPF and ACN, including improvement of reporting practices from the “top down” (i.e. RCCA budgets and reporting should fit within the UCCA budgets/reporting, which should fit within the SPF and GOU budgets and reporting). This will also assist in uniting all parties responsible for implementing Ukraine’s Mass Privatization Program and will promote common goals, objectives, and, therefore, results within the SPF and the ACN.

- IV. ***Standards for Communication Channels within the ACN.*** As mentioned above, one of the most apparent problems within the ACN is a lack of communication among RCCAs, between RCCAs and the UCCA and between the UCCA and the SPF regarding regulatory procedures, implementation of regulations, “best practices” and planning/budgeting. As such, the UCCA and SPF might also facilitate and standardize ACN operations by concentrating efforts on establishing strong communication channels within the ACN and between the UCCA and SPF. Of primary importance are efforts to improve training of personnel in management techniques and/or job-related responsibilities, training of specific personnel regarding existing regulatory procedures and/or the introduction of new regulatory procedures, knowledge sharing across RCCAs regarding implementation of procedures and controls, and instructional guidance and assistance with operational, procedural or resource problems within the ACN.
- V. ***Assistance from the UFPA Regional Network.*** One final recommendation is for the SPF to investigate establishing a policy which requires all ACN members in accounting or financial positions to become members of the Ukrainian Federation of Professional Accountants (the Federation). The Federation, which is Ukraine’s first professional accounting organization (although it charges a nominal membership fee for individuals) is a valuable resource for learning Western accounting principles, including International Accounting Standards, and other accounting and reporting related developments within Ukraine. The Federation has member branches in each oblast in Ukraine. Our experience with the SPF and within the ACN showed that, although most individuals to whom this type of information would be most useful were interested in obtaining the information, upper level management declined to promote such learning due to time, resource and cost restraints. As such, the Federation network would be a viable option to provide this training, at a low cost, on staff members’ “own time”, and in a convenient and professional manner within each region of Ukraine.

Appendix I

Listing of Regulations Related to Auction Center Network Functions

(Note that some regulations are not listed here as they do not detail procedures with which the ACN should comply, but merely give authority to the Orders which do detail such procedures; i.e. certain Presidential Decrees).

Certificate auctions

February 24, 1995	CabMin Order # 144	Certificate Auction Centers
March 27, 1995	CabMin Order #218	Conducting Auctions
March 27, 1995	SPF Order #191	Temp: Regional Auctions
May 29, 1995	SPF Order #618	Sales Information Publication
February 21, 1996	SPF Order #189	Regional Certificate Auctions
January 28, 1997	SPF Order #93	Sales of Shares of Mun.Property

Auction Center Network

February 24, 1995	CabMin Order # 144	Certificate Auction Centers
April 17, 1995	SPF Order #428	UCCA
April 17, 1995	SPF Order # 429	RCCAs
August 28, 1995	SPF Order #1103	BRSs
December 13, 1995	SPF Order #1519	UCCA Mgmt. Bodies
January 31, 1996	PW/Oschad Bank/UCCA	BRS sites in Oschad Bk.
December 30, 1996	CabMin	Joint Stock - ACN

Financing of Auction Center Network

February 1, 1996	PW/ACN	Rent, payroll, (no bonuses)
April 15, 1997	PW/ACN	Performance Based
December 31, 1997	PW/ACN	End of financing

Compensation Certificates

July 20, 1995	Ministry of Justice, Order #229-765	Indexation
February 7, 1996	COM Res. #161	Circulation of CCs
February 29, 1996	PW/Oschad Bank/UCCA	Amend 1/31 - to include CCs.
March 28, 1996	COM Res. #363	Sales of shares of JSC for CCs
April 5, 1996	SPF Order #395	Cert. Auctions
April 8, 1996	SPF Order #399	CC Appl. Forms for bids
April 11, 1996	UCCA, Order #23	Instruction - Cert. Auctions
May 5, 1996	SPF, Order #56	Legal Entities
May 15, 1996	Ministry of Finance Order #97	Accounting
May 15, 1996	SPF Instruction #10-19-4852	Circulation Procedures
May 17, 1996	SPF Order #542	Protocol on auction results
June 5, 1996	NBU Order #137	Cancellation/Storage
July 18, 1996	UCCA Instruction #87	Collection/process. apps. - FIs
August 11, 1996	NBU, Order #83	Distribution
November 21, 1996	Law of Ukraine	State Guaranties
December 5, 1996	SPF Order #1486	CCs and Appl. not accepted
December 25, 1996	SPF Order #1628	CC auction Reporting
Jan. 28, 1997	SPF Order #93	Municipal Property Sales

Shareholder Registry

December 1, 1995	SPF Instruction #10-19-8279	Share registries
March 2, 1996	SSMC Reg. #247	Amend. Pres. Decree #247
March 19, 1996	Pres. Decree #244/97	Registration of Ownership Rts.
April 1, 1996	SSMC Reg. #58	Maintain Registries

April 1, 1996	SSMC Reg. #59	Issuing Registration permits
October 17, 1996	SPF Order #1244	Transfer Share Reg. from ACN
October 23, 1996	UCCA Order #155	Transfer Share Reg. from ACN
February 7, 1997	SPF Order #691	Transfer Share Reg. to SPF

Privatization Property Certificates

November 2, 1992	SPF Order #467	Settlements for Privat. Objects
April 21, 1994	Pres. Ukr. Decree #178/94	PPC Circulation
March 2, 1995	SPF Order #231	Tsfr. disks - RCCA to UCCA
March 14, 1995	NBU Regulation #53	Storage, Acct., cancel. certif.
April 19, 1995	SPF Order #437	Participation of FIs and BAs
April 27, 1995	SPF Order #478	Protocol on auction results
June 20, 1995	SPF Order #741	Auction price calculation
July 11, 1995	UCCA Order #17	Processing bids -
Citizens/FIs		
August 10, 1995	SPF Order #1046	Bid reception procedures
September 27, 1995	UCCA Order #31	Bid reception/processing
proced.		
November 14, 1995	SPF Order #1378	Access to Cert. Auction Info.
January 22, 1996	CabMin Order # 106	Amendments to #144
February 21, 1996	SPF Order #191	Appl./Cert. not accepted in auction
March 28, 1996	SPF. Reg. #342	FI participation in the Auctions
November 25, 1996	CabMin Res. #1416	Amend/Changes to CabMin#218
May 15, 1997	SPF Order #515	Shares Sale for residual priv. acc.
March 27, 1998	SPF Order #603	Amend to SPF Order #342

Financial Intermediaries

March 28, 1995	Pres. Dec. #265/65	Inv. Funds & Inv. Companies
March 20, 1995	SPF Order #295	IF bid reception/processing proc.
April 19, 1995	SPF Order #437	Ensuring participation of FIs
April 20, 1995	SPF Instruction #10-19-2793	Implementing Order #295
April 20, 1995	SPF Instruction # 1086	Amendments to #295 and Instr.
March 26, 1996	SPF Order #342	Submitting applications by FIs

Appendix II

Listing of Audit Visits by Oblast and Date July 1, 1995 - May 31, 1998

RCCA	Date of 1st Audit Visit	Date of 2nd Audit Visit	Date of 3rd Audit Visit	Date of 4th Audit Visit
Odessa	Jul. 24-Jul. 28, 1995	Feb. 18-Feb. 21, 1996	Jun. 30-Jul. 5, 1997	
Kirovograd	Jul. 31-Aug. 4, 1995	Aug. 12-Aug. 16, 1996		
Ivano-Frankivsk	Aug. 14-Aug. 17, 1995	Jan. 14-Jan. 17, 1997		
Kherson	Aug. 14-Aug. 18, 1995	Jul. 9-Jul. 12, 1996	Feb. 26-Mar. 1, 1997	Feb. 1-Feb. 4, 1998
Chernigiv	Aug. 21-Aug. 23, 1995	Feb. 12-Feb. 16, 1996		
Lugansk	Aug. 28-Sep. 1, 1995	Jul. 22-Jul. 26, 1996	Aug. 4-Aug. 8, 1997	
Chernivtsy	Sep. 11-Sep. 15, 1995	Feb. 3-Feb. 7, 1997		
Lviv	Sep. 11-Sep. 15, 1995	Mar. 4-Mar. 6, 1996	Feb. 26-Mar. 1, 1997	
Mykolaiv	Sep. 18-Sep. 22, 1995	Oct. 21-Oct. 25, 1996		
Donetsk	Sep. 25-Sep. 29, 1995	Mar. 8-Mar.11, 1996	Sep. 23-Sep. 27, 1996	Nov. 10-Nov. 14, 1997
Zakarpatye	Sep. 4-Sep. 7, 1995	Jan. 27-Jan. 31, 1997		
Kharkiv	Nov. 13-Nov. 16, 1995	May 27-May 31, 1996	Jun. 2-Jun. 7, 1997	
Sympheropol	Oct. 16-Oct. 20, 1995	Jul. 1- Jul. 6, 1996	Dec. 22 - Dec. 26, 1997	
Sevastopol	Oct. 16-Oct. 19, 1995	Sep. 2-Sep. 6, 1996	Jul. 7-Jul. 12, 1997	
Zhytomir	Oct. 24-Oct. 27, 1995	Dec. 2-Dec. 6, 1996		
Cherkassy	Oct. 3 - Oct. 5, 1995	Dec. 24-Dec. 27, 1996		
Khmelnitsky	Oct. 30-Nov. 2, 1995	Mar. 3-Mar. 7, 1997		
Dnipropetrovsk	Oct. 31-Nov. 3, 1995	Apr. 8-Apr. 11, 1996	Sep. 1-Sep. 5, 1997	
Sumi	Nov. 12-Nov. 15, 1995	Oct. 7-Oct. 11, 1996	Nov. 17 - Nov. 21, 1997	
Zaporizhye	Nov. 13-Nov. 17, 1995	Mar. 11-Mar.15, 1996	Dec. 8 - Dec. 12, 1997	
Ternopil	Nov. 23-Nov. 27, 1995	Sep. 18-Sep. 20, 1996	Jan. 19 - Jan. 23, 1998	
Vinnitsa	Nov. 27-Dec. 1, 1995	Sep. 16-Sep. 20, 1996	Aug. 18-Aug. 22, 1997	
Volyn	Nov. 28 - Nov. 30, 1995	Jun. 24-Jun. 28, 1996		
Poltava	Dec. 4-Dec. 7, 1995	Sept. 27 - Sept. 30, 1996	Oct. 27 - Oct. 31, 1997	
Rivne	Dec. 26-Dec. 28, 1995	Oct. 13-Oct. 18, 1997		
Kyiv	Jan. 10-Jan. 23,1996	Apr. 17-May 23, 1997		
UCCA	Feb. 8-Feb. 12, 1996	Nov. 18-Dec. 23, 1996	Sep. 4-10, 1997	

Appendix III

Summary Audit Findings (Previously Issued in 1/96)

July 1995 - December 31, 1995

During our audit visits, we noted that the following were problem areas within the ACN and our findings/recommendations were common among RCCAs. For a full summary of findings by center, see the report beginning on the next page.

RCCAs

- Preparation and maintenance of updated consolidated storage logbook, detailing certificate stored within the RCCA and summarizing certificate transactions within the RCCA and with external organizations.
- Test counts of certificates for reconciliation with consolidated storage logbook and accounting records.
- Preparation and maintenance of updated Equipment List, detailing equipment within the RCCA and summarizing broken/damaged equipment and transfers of equipment to and from other centers within the ACN.
- Test counts of equipment for reconciliation with inventory list and accounting records.
- Segregation of duties of the individual responsible for the operations of the vault (Vault Manager).
- Limiting access to the vault; safeguarding of certificates.
- Adequacy of certificate storage facility.
- Transfers of certificates to the bank - bank fee charged; acceptance of small number of certificates by the bank; limited period of acceptance of certificates by the bank.
- Cancellation of certificates.

UCCA

- Delayed issuance of auction results from the UCCA in some cases increased the number of certificates stored in an uncancelled state within RCCAs.

Appendix IV

Summary Audit Findings

January 1, 1996 - May 31, 1998

Audit Work:

Representatives from Price Waterhouse LLC (PW) visited Regional Centers for Certificate Auctions from 1996 through 1998 under three USAID/PW Task Orders to perform audit procedures in accordance with Task Order requirements. The main objective of this section is to summarize the results of these audit visits and procedures performed at the auction centers visited during the time frame of these Task Orders. Our testing was designed to assess whether the auction centers' internal control structure and accounting documentation were operating in a manner which would provide reasonable assurance that material errors and misappropriations would be detected. Audit procedures performed included the following:

- review of the process used to accept Compensation Certificates (CC) and Privatization Property Certificates (PPC) and the accounting records used to maintain this bidding information;
- examination of the internal control structure to determine whether the auction centers adequately records, processes, summarizes, and reports auction data consistent with privatization legislation and procedures approved by the Government of Ukraine;
- reconciliation of the number of certificates collected by the auction centers to the number of certificates stored at the auction centers and other locations;
- examination of auction centers' cancellation procedures and determination of whether winning certificates are being cancelled in accordance with current regulations;
- verification of whether the United States Agency for International Development (USAID) computer equipment transferred by PW is physically located at auction centers by using the PW_ADP protocol, which details equipment transferred to the Auction Center Network (ACN). We reconciled this information to the Inventory List maintained by auction centers and to the equipment physically located in auction centers;
- performance of limited sample testing of the auction center expenses incurred both during the financing of auction centers and in subsequent operating periods, including its payroll by obtaining the PW monthly auction center expenditure reports for related periods. We judgmentally selected expenses for testing and reviewed supporting documentation for these expenditures. We also investigated any unusual expenditures made during the period to determine that the purchases were valid and for ACN business purposes;
- review of procedures used to maintain and transfer information from the temporary shareholder database.

The work entailed interviewing auction center personnel, examining detailed accounting records supporting auction information, testing the consolidation of Bid Reception Site (BRS) data, testing the cancellation status of stored certificates, and performing physical counts of certificates on hand. We also examined documentation supporting expenses which were financed by USAID via PW for equipment and payroll. Our examination was limited to these procedures and had we performed additional procedures or made a review in accordance with generally accepted auditing standards, other matters may have come to our attention which would have been included in our Reports of Findings.

During our audit visits, we noted that the following were problem areas within the ACN and our findings/recommendations were common among RCCAs.

RCCAs

- Accounting for CCs 1) on a daily basis, 2) using a subsidiary ledger, and 3) in accordance with Ministry of Finance Order #97.
- Difficulty implementing new regulations: 1) introduction of compensation certificates and 2) Financial Intermediary regulation.

- Management reviews; checking work performed (i.e. PPC/CC Tellers Logs, applications).
- Data entry procedures: signing applications after entry into the system.
- Data entry procedures: data reconciliation between data entered in the system and data received from the Data Distribution Department.
- Documentation of internal transfers of certificates between departments.
- Preparation and maintenance of updated consolidated storage logbook, detailing certificates stored within the RCCA and summarizing certificate transactions within the RCCA and with external organizations.
- Test counts of certificates for reconciliation with consolidated storage logbook and accounting records.
- Preparation and maintenance of updated Equipment List, detailing equipment within the RCCA and summarizing broken/damaged equipment and transfers of equipment to and from other centers within the ACN.
- Test counts of equipment for reconciliation with inventory list and accounting records.
- Certificates stored in multiple locations and/or not stored properly (safeguarding of certificates).
- Adequacy of certificate storage facility.
- Cancellation of certificates.

UCCA

- Preparation and maintenance of updated Equipment List, detailing equipment within the RCCA and summarizing broken/damaged equipment and transfers of equipment to and from other centers within the ACN.
- Test counts of equipment for reconciliation with inventory list and accounting records.

Two Noted Violations of Financing Agreement

1. Sevastopol RCCA
2. Ternopil RCCA

**CAPITAL MARKETS MONITORING UNIT
KYIV, UKRAINE**

**PRICE WATERHOUSE LLP
COMPLETION REPORT**

JUNE 3, 1996

I. EXECUTIVE SUMMARY

The Capital Markets Monitoring Unit (CMMU) in Kiev, Ukraine, was established in early 1995 with capital markets and information technology consulting and technical assistance from Price Waterhouse LLP. Since then, the CMMU, staffed with Ukrainian professionals and Price Waterhouse capital markets consultants with broad regulatory experience, has monitored and analyzed the Ukrainian capital markets and the activities and operating practices of market participants. Based on its monitoring and analysis, the CMMU and Price Waterhouse consultants have prepared for the Government of Ukraine (GOU) extensive regular and ad hoc reports on market developments, policy and regulatory issues, and the activities and operating practices of market participants.⁷ Among other things, the CMMU has also organized and participated in training seminars on various capital markets issues, and participated jointly with the GOU on compliance inspections of market participants using a Compliance Inspections Manual developed by the CMMU.

In its reports, deliverables and meetings with its counterparts in the Ukrainian government, the CMMU has identified and analyzed a number of different issues and developments in the Ukrainian capital markets, and has offered recommendations and suggested courses of action for the GOU. As more fully described below, among the major issues examined by the CMMU are: (1) substantial accumulation of privatization property certificates by a small number of financial intermediaries, (2) possible collusion, manipulation, and evasion of legal obligations by financial intermediaries, particularly in connection with privatization certificate auctions, (3) low level of compliance with periodic reporting and disclosure obligations by financial intermediaries, (4) poor financial health of many financial intermediaries, (5) intermediary failure to participate actively in the management or restructuring of enterprises, (6) efforts by some enterprises to disenfranchise shareholders, and (7) enforcement of the securities laws by the GOU. As the CMMU transfers to the new contractor, it should continue to monitor these and other developments in the Ukraine market.

II. OVERVIEW OF THE CMMU

⁷ All of the CMMU's reports and deliverables have been previously forwarded to USAID-Roslyn and USAID-Kiev. In addition, Price Waterhouse recently compiled the CMMU's major reports into one volume, and distributed that volume to the USAID offices in Roslyn and Kiev.

a. Introduction and Objectives

The overall purpose of the CMMU is to serve as an informational, analytical and advisory resource for the Ukrainian government on the capital markets, in essence, to be the “eyes” and “ears” of the government with respect to the capital markets. Accordingly, a significant component of the CMMU’s work -- and one to which the unit devotes a considerable amount of its resources, as more fully described below -- is collecting and analyzing market information.

To accomplish this goal, the CMMU has developed a computer database of market information that tracks the identities and activities of investment funds and trust companies. By so doing, the CMMU seeks to be a source of market information and analysis for the government so that it can keep abreast of an increasingly active and rapidly changing market. In this way, the CMMU can assist the Ukrainian government to understand the market and its participants so that Ukrainian market regulators can make reasoned forecasts or respond in a timely and appropriate manner to market developments and misconduct, and to establish an effective and appropriate regulatory and legislative framework. Reliable and timely market information and analysis is a necessary prerequisite and foundation for such a framework.

One of the primary purposes of the CMMU is to develop and analyze market information so that it may alert the Government of Ukraine (GOU) to developments or conduct in the capital markets that may damage the integrity of the mass privatization program or the public’s confidence in it. Accordingly, the CMMU has focused its resources on the activities and operating practices of financial intermediaries and the nature and extent of their participation in privatization certificate auctions, with particular emphasis on their conduct in the markets and their treatment of investors. The CMMU reports its findings directly to the GOU -- principally the State Property Fund and the State Commission on Securities and the Stock Market (SCSSM) -- in regular and ad hoc informational and analytical reports. These reports include not only information about the activities and operating practices of market participants, but also discussion and recommendations relating to market developments, trends and policy and regulatory issues. In this way, the CMMU acts as an early warning mechanism for the GOU to help it understand and identify problems in the market or with specific market participants, and to help it respond in a timely and appropriate manner. This market information assists the GOU to fulfill its responsibilities for establishing, administering and enforcing securities market policies and rules.

b. Staff

The CMMU -- like its sister monitoring units in Russia, Moldova and Kyrgyzstan -- is intended to eventually merge into the SCSSM. With this objective in mind, Price Waterhouse devoted a considerable amount of time and effort to locate and recruit talented Ukrainian professionals, and to provide capital markets training once they were hired. Various staff members also attended seminars and conferences in Kiev on pertinent subjects. Currently, there are seven full-time Ukrainian professionals on the CMMU’s staff, including two lawyers, four economists and a translator. In addition, two professors of economics

and finance from the local affiliate of the International Management Institute in Kiev are part-time advisors to the unit.

c. Transition to New Contractor and Workplan Going Forward

As required in the Task Order, Price Waterhouse has taken numerous steps to ensure the transition of the CMMU to the new contractor is orderly and without disruption. Among other things, Price Waterhouse has continued to maintain and update the database of market information pending this transition, and has prepared all necessary documentation and user manuals to ensure a smooth transition. In addition, Price Waterhouse has provided (or will provide) the new contractor with all CMMU reports, relevant files and reference materials. In several meetings with representatives of the new contractor, the ongoing work of the CMMU was described and explained, and a brief written descriptive workplan was developed by Price Waterhouse for the new contractor. This workplan described the unit's current monitoring and reporting responsibilities, and also detailed the CMMU's ongoing activities and projects. These projects include, among others:

- (1) continued joint participation with the SCSSM in inspections of financial intermediaries,
- (2) review and analysis of 1995 annual reports filed with the SPF by intermediaries,
- (3) analysis of the nature and extent of intermediary participation in recent privatization certificate auctions,
- (4) at the request of the SPF, develop a questionnaire to survey intermediaries intentions after mass privatization, and compile and analyze the results,
- (5) provide training to the membership of the Ukrainian Association of Investment Businesses on the CMMU's Compliance and Inspections Manual, and
- (6) update the CMMU's Survey of the Capital Markets in Ukraine.

Further, CMMU computer hardware and software, equipment, and furniture will be transferred. Price Waterhouse has separately provided detailed specifications and inventories of these items to USAID and the new contractor. Price Waterhouse has also discussed various administrative matters with the new contractor and documented them as necessary. Lastly, Price Waterhouse has forwarded CMMU staff resumes to the new contractor, and has arranged for representatives of the new contractor to meet the CMMU's staff.

III. CMMU ACCOMPLISHMENTS

a. Developed and Expanded Capability to Collect and Analyze Market Information

Since its establishment in early 1995, CMMU analysts have traveled to every major city and region in Ukraine, and have met with representatives of several hundred market participants and government officials. The CMMU has found that such face-to-face meetings are the most effective means to gather information, particularly given the undeveloped state of periodic reporting and the lack of a sophisticated business press. These meetings also allow CMMU analysts to introduce and discuss various capital markets concepts with the private and public sectors, such as disclosure and transparency, and serve to introduce the CMMU and its staff to the private and public sector and gain their cooperation. These meetings and trips will continue for the foreseeable future. In fact, the CMMU has started to re-visit the large regions and major market participants.

The CMMU has conducted extensive surveys of market participants on different issues, which has also been an effective means to gather information. For example, the CMMU has surveyed newly-privatized enterprises regarding their corporate governance practices, and trust companies regarding their periodic reporting practices. The CMMU compiles the responses and prepares an informational and analytical report for the GOU. Very often, these surveys are conducted at the request of a particular government body. Recently, the SPF has asked the CMMU to survey financial intermediaries regarding their post-privatization plans, which is discussed more fully below. This project is ongoing and should be completed later this summer.

Through these meetings, surveys and other means of information-gathering, the CMMU has developed extensive and detailed market information regarding financial intermediaries. To the extent allowed by the CMMU's software, this information is input into the CMMU's database of market information. As of May 1, 1996, the CMMU database contained information regarding 381 investment funds and companies, 372 trust companies, 393 securities traders, 499 investment managers, 139 banks, 122 depositories, 123 auditors, 9 pension funds, 3 industry associations, and 141 branches of investment funds and companies, and trust companies. Among other things, this data includes information regarding intermediary licenses (including suspensions and revocations), registration, financial statements, authorized capital, dividend payments, management companies, banks, affiliated persons, and auditors.

Through these meetings and surveys, the CMMU has developed excellent working relationships with representatives of the private and public sectors, most notably with Chairman Moscovy and Commissioner Boyko from the SCSSM, and Marina Vasina from the SPF. These relationships have been invaluable for the CMMU, and have substantially assisted the unit's efforts to collect license and other information. In addition, the CMMU has also endeavored to develop mutually beneficial working relationships with other capital markets contractors, and has coordinated its efforts with its sister monitoring units in Moscow and Chisinau, sharing information and analyses.⁸

⁸ CMMU analysts have taken several trips to Moscow and Chisinau to visit with the monitoring units in those cities, and members of the Chisinau monitoring unit traveled to meet with the CMMU and the SCSSM to discuss capital market developments in Moldova.

b. Regular and Ad Hoc Reports

Since its inception, the CMMU and Price Waterhouse consultants have produced regular monthly “activity” reports, which present information and analysis developed by the unit in the preceding month. These reports -- which are distributed to the SPF, SCSSM, the Ministry of Finance, and the Cabinet of Ministers, among others -- review the activities and operating practices of market participants, and include analyses of various additional issues related to financial intermediaries, such as the nature and extent of their participation in certificate auctions, their advertising practices, review and analysis of their periodic reports filed with the SPF, their accounting practices, and the development of industry associations, among other issues. In addition, these reports have addressed various policy and regulatory issues and often include recommended actions and legislative proposals to address these issues. In addition, the CMMU and Price Waterhouse consultants have complemented these reports and deliverables with follow-up meetings to discuss and explain the unit’s findings and recommendations.

In addition to these regular monthly reports, the CMMU has also undertaken numerous ad hoc reports, often at the request of GOU agencies. For example, the CMMU has examined various compliance, accounting and licensing issues on behalf of the SPF, and has documented and reported its findings and recommendations to the SPF. Recently, the SPF has sought the assistance of the CMMU to survey financial intermediaries as to their post-privatization plans. Accordingly, the CMMU has developed a questionnaire for intermediaries, and will analyze their responses and compile them into a report for the GOU as soon as sufficient responses are received.

As required in the Task Order, the CMMU and Price Waterhouse consultants have also completed a Compliance and Inspections Manual for Investment Funds and Trust Companies to assist the GOU conduct inspections of intermediaries. The SPF and SCSSM have both used this Manual to guide their inspections, and CMMU analysts have participated jointly with these government agencies on several such inspections. The CMMU recently completed an addendum to this Manual. The CMMU has also planned a seminar for the Ukrainian Association of Investment Businesses (UAIB) -- an industry association -- to explain and describe the Compliance Manual. The CMMU has encouraged the UAIB to implement a compliance and inspections program as a condition of membership.

Furthermore, the CMMU has also completed extensive recommendations regarding financial reporting and disclosure by intermediaries under current Ukrainian accounting standards. The general purpose of these recommendations is to improve intermediaries’ reporting to investors and regulators. In conjunction with these recommendations, the CMMU presented a seminar to the membership of the UAIB on periodic reporting, which was attended by representatives of about 25 intermediaries. The CMMU has also strongly encouraged the UAIB to adopt these recommendations as conditions of membership.

Other CMMU reports and deliverables related to disclosure and reporting include:

- (1) Review and Survey of Trust Companies Regarding Their Reporting Practices,

- (2) Review and Analysis of 1995 Third Quarter Reports filed by intermediaries with the SPF,
- (3) Review and Analysis of 1995 Annual Reports (ongoing), and
- (4) Proposal for a Public Information Center.

In addition to disclosure-related issues, the CMMU has also prepared comprehensive Surveys of the Capital Markets, which provide an overall “snapshot” of the identity and activities of market participants. The CMMU has also focused on issues related to corporate governance and has prepared an Analysis of the Existing Legal and Regulatory Framework for the GOU. Similarly, the CMMU has surveyed newly-privatized enterprises regarding their corporate governance practices, and presented its findings in a report to the GOU. CMMU lawyers also participated in numerous corporate governance and shareholder rights seminars organized by Price Waterhouse which were held throughout Ukraine.

Other deliverables prepared by the CMMU and distributed to its counterparts in the government include:

- (1) Securities Law Enforcement in Ukraine: General Guidelines for the Application of Sanctions to Violations of Current Legislation by Investment Funds and Trust Companies,
- (2) Self-Regulation in the Ukraine Securities Market, and
- (3) Regulatory Strategy for the SCSSM.

IV. MAJOR ISSUES

In its reports and deliverables, the CMMU has identified and examined numerous issues and trends in the Ukrainian capital markets, and offered recommendations and suggested courses of action for the GOU. Here are brief discussions of several major issues examined by the CMMU in the last year, and their implications for the developing capital markets in Ukraine. All of these issues have been previously raised with the GOU and USAID:

a. Intermediary Accumulation of Privatization Certificates

As of May 1, 1996, the SPF had issued a total of 723 licenses to financial intermediaries that authorize them to work with privatization property certificates (PPCs). These intermediaries have collected the large majority of PPCs that have been distributed. Moreover, according to information developed by the CMMU, as of October 1, 1995 (the latest date for which information is currently available), 15 closed-end investment funds and companies had accumulated more than 80 percent of all PPCs accumulated by investment funds and companies, but had invested on average only about 25 percent of their accumulated certificates. Several of these intermediaries had not, as of October 1, 1995, invested a single PPC.

This significant concentration of PPCs has several implications for investors, the government and the industry. First, from investors’ perspective, it is important to note that to obtain a license from the SPF, Ukrainian law requires investment funds and companies to

be closed-ended.⁹ Such funds do not assume any obligations before the end of mass privatization to repurchase investment certificates which they issue to investors in exchange for PPCs. The CMMU is concerned that when privatization by certificate auction is completed, which is currently scheduled for December 31, 1996, some investment funds and companies may not act in the best interests of their investors and certificate holders. For example, it is possible that some closed-end funds may terminate their operations and improperly refuse to repurchase certificates from certificate holders, or they may repurchase certificates at a price that does not reflect the fund's net asset value (NAV) or fair market price, if a secondary market exists. While the CMMU has not developed any direct evidence of these types of activities, they nonetheless should be cause for concern.

In addition, under current market conditions in Ukraine, the assets of many investment funds are not liquid, which makes determination of NAV exceedingly difficult, if not impossible. Such market conditions provide opportunities for abuse, particularly by fund managers, directors and others affiliated with investment funds. These "insiders" may benefit from their access to "inside" information about the activities or operations of the fund, and consequently engage in transactions to their financial benefit (such as repurchasing investment certificates at an inflated price) but to the detriment of other investment certificate or share holders.

Further, it is conceivable that a large number of investment funds could terminate their operations virtually simultaneously, which may disrupt the market and possibly harm investors. Conversely, some investment funds may not terminate operations, but may seek to convert themselves into open-end funds. Under these circumstances, Ukrainian law provides that investors may demand redemption of their investment certificates almost immediately. Given the poor financial health of many intermediaries, some funds may not be able to satisfy investor redemption demands, and may be required to obtain bank loans or other forms of financing in order to satisfy these demands. Eventually, it is possible that these creditor banks may eventually obtain control over the portfolios of their debtor investment funds where funds are not able to repay these loans.

These circumstances have other implications for the market. If there are abuses, failures or other market disruptions, investors (both domestic and foreign) will likely lose confidence in investment funds and other market participants, and may seek alternative places to invest. In addition, given such a substantial concentration in the industry, the failure of one or more of the large investment funds could substantially affect the health of the market and individual investors.

To address these concerns and assist Ukraine's market regulators, the CMMU and Price Waterhouse consultants have submitted a number of proposals to the GOU. In brief, these recommendations, which are discussed more fully in CMMU reports, include: (1) to require investment funds to repurchase investment certificates for either market value (if there is a reliable secondary market) or at the NAV; (2) to require funds to disclose to sellers the fund's NAV at the time of repurchase, (3) to prohibit funds from discriminating against different categories of investors, (4) to prohibit funds from paying commissions or

⁹ Ukrainian law also provides that investment funds may convert into open-end funds, but only after the end of the period within which PPCs may be utilized, which is currently December 31, 1996.

other fees to affiliated or related parties who assist the fund to repurchase certificates, such as brokers, (5) to require funds to pay promised dividends before they repurchase certificates, (6) to require funds to distribute a specified portion of their net income for the preceding year to certificate holders during that year or within a specified time thereafter, (7) to require funds to provide investors with written confirmation of any repurchases, (8) to require funds to file periodically with the SPF and/or SCSSM a written report of all repurchases and any written solicitations or prospectuses sent to certificate holders regarding any such repurchases, (9) to develop clear procedures for the liquidation of closed-end investment funds and settlement with their investors, and procedures for closed-end funds that wish to convert to open-end funds, and (10) to require investment funds to notify the government as to their intentions after the end of privatization. To date, Price Waterhouse understands that the GOU has not acted on any of these recommendations.

b. Intermediary Participation in Certificate Auctions

According to information developed by the CMMU, as of January 1, 1996, financial intermediaries have submitted on average between 77 and 96 percent of all PPCs bid at the monthly certificate auctions held to that time, and between 85 and 98 percent of winning bids. The significant extent of intermediary participation in certificate auctions raises several serious issues. As the CMMU has previously reported, the unit has found that some intermediaries engage in certain transactions, which may not necessarily violate current Ukrainian legislation, but which may nonetheless harm investors and the market.

For example, the CMMU has found that intermediaries will enter into agreements with other intermediaries prior to a certificate auction, and determine who will bid for a particular enterprise, and how much. In these situations, the intent is to manipulate the cost of the enterprise's shares (as well as possibly the fee that intermediaries charge to their clients), which not only damages the integrity of the auction system and the market, but also enables the intermediary to benefit at the expense of citizens. The CMMU has also found that in some instances the intermediary will sell, pursuant to a prearranged agreement, enterprise shares to the management of that enterprise to ensure that management maintains control over the enterprise, despite the apparent transfer in ownership from the state to the private sector.

Similarly, intermediaries will enter into such prearranged agreements in order to evade certain legislative requirements such as the regulation that limits intermediaries' investment in one enterprise to five percent of the intermediaries' assets. The CMMU has also found several instances where intermediaries refused to pay (that is, submit PPCs) for enterprises the shares of which they had won at certificate auctions, probably because the share price was higher than anticipated or they received fewer shares than desired. Such collusion, evasion of legal obligations and apparent market manipulation reinforces the need for the government to regulate fairly the activities and operating practices of intermediaries and protect the interests of shareholders.

c. Reporting and Financial Health of Intermediaries

The CMMU has found that compliance by intermediaries with their periodic reporting responsibilities is low. For example, only 170 out of 237 investment funds and

companies, or 72 percent of those licensed by the SPF, filed a complete 1995 annual report as required by Ukrainian regulations. Many investment funds and companies filed incomplete reports, and 29 did not file anything at all. Similarly, the CMMU has found that 317 out of 362 licensed trust companies filed complete or partially complete 1995 annual reports with the SPF, or about 88 percent of the total licensed by the SPF. 45 trust companies did not file anything at all.

CMMU analysis of the contents of intermediaries' periodic reports revealed further deficiencies in their reporting, and raise concerns about the overall financial health of the industry. For instance, CMMU analysis of the 22 largest investment funds and companies shows that in almost all cases, founders of many of these intermediaries finance ongoing operations; the funds do not generate sufficient revenues from ongoing business activities to pay for expenses such as salaries, rent and advertising. The CMMU has also found that some of these intermediaries reported large accounts payable, which suggests that funds are not generating revenues to finance ongoing operations. Given the extreme concentration of intermediaries in the Ukrainian market, as noted above, the CMMU is very concerned about the financial health of such large market participants.

CMMU analysis of these reports and other materials also shows that some intermediaries appear to violate certain Ukrainian laws and regulations. These apparent violations include improper composition of assets, possible overstatement of assets and net asset valuation, improper loans and improper composition and amount of authorized capital. The CMMU has reported all of these possible violations -- and identified the intermediaries -- to the SPF and SCSSM.

d. Corporate Governance and Shareholder Rights

In a few limited cases, the CMMU has found that investment funds have sought to participate in the management and restructuring of enterprises in their portfolios. In most instances, however, the CMMU has observed that intermediaries tend to concentrate on portfolio management rather than on active participation in the management of enterprises. In addition, legal limitations on the amount that an intermediary may invest in a particular enterprise may contribute to the incentives for investment funds to act as portfolio managers instead of strategic investors. Similarly, as noted above, a small number of intermediaries represent the large majority of holders of PPCs and are the most active participants in certificate auctions. This situation suggests that there is little or no competition among intermediaries, which further limits the options for investors and the incentives for intermediaries to increase shareholder or participant value.

The CMMU has identified a few basic variants that describe the nature and extent of the participation of many intermediaries in certificate auctions. The largest group of intermediaries now participate in auctions only “to the order” of specific client-investors. These intermediaries act essentially as brokers, and do not intend to develop a diversified portfolio. In some instances, the client-investors of these intermediaries represent the enterprise’s management. In a few other cases, the CMMU has found that intermediaries were established to invest in one enterprise only, again sometimes at the behest of that enterprise’s management. When the certificate auction is completed for the enterprise, this type of intermediary sells these shares and subsequently terminates operations. Other intermediaries purchase blocks of shares of enterprises at certificate auctions and then actively seek to sell these shares to investors.

While these activities do not necessarily violate Ukrainian law, they suggest that many intermediaries do not intend to actively manage their portfolios. This conduct has several implications, including that intermediaries will probably not act as agents of change at most enterprises, and that investment funds may not act in the best interests of their investors or seek to increase shareholder value.

One disturbing trend identified by the CMMU has been that some enterprises actively attempt to limit the voting rights of shareholders, or even seek to completely disenfranchise shareholders, which under certain circumstances is apparently not prohibited by current Ukrainian legislation. One way enterprises limit voting rights is to determine the number of shares held by certain shareholders, and then require that shareholders must hold more than that number to vote at shareholder meetings. The CMMU has brought this situation to the attention of the SPF and the SCSSM, and has offered recommendations on how to address this situation.

e. **Enforcement of Securities Laws**

In connection with its task order responsibilities to assist the GOU to ensure the integrity of intermediary participation in the mass privatization program, the CMMU prepared and distributed to its counterparts in the GOU an Enforcement Guide which sets forth basic principles of securities law enforcement and how they may be applied under existing Ukrainian laws. In addition, the CMMU prepared and presented to the SCSSM a Regulatory Strategies paper, which in part outlines the enforcement responsibilities of a securities regulator.

The CMMU also prepared for the GOU a Compliance and Inspections Manual for Investment Funds and Trust Companies, which the CMMU has recently supplemented with more detailed guidelines. Both the SPF and the SCSSM have used this Manual to guide their inspections of financial intermediaries, and monitoring unit analysts have participated jointly with these government agencies in several inspections. These inspections have identified several possible violations of Ukrainian legislation, and it is the CMMU's understanding that the SPF and SCSSM intend to impose sanctions such as license suspensions or revocations where violations have been discovered.

Furthermore, in its regular and ad hoc reports, the CMMU has referred a large number of possible securities law violations to the SPF and SCSSM for enforcement action. These alleged violations have related to several different areas, but principally to possible violations of laws and regulations relating to intermediary periodic reporting obligations¹⁰, accumulation and use of PPCs, amount and composition of authorized capital, intermediary asset composition and other accounting matters, limits on volume of trust company operations, general shareholder meetings, and advertising.

In addition, the CMMU prepared and presented to the SCSSM a paper entitled "Self-Regulation in the Ukraine Securities Market," which in part outlines the surveillance and disciplinary mechanisms of self-regulatory organizations (SROs). In Ukraine, SROs in the Western sense do not currently exist, although there are several industry associations that are active in the Ukraine market, including the UAIB. Recently, the UAIB elected to suspend a member -- NaftaEnergInvest -- from the Association for alleged violations of the UAIB's Code of Ethics related to advertising. While the Association's action can be viewed as self-serving and anti-competitive -- NaftaEnergInvest is a large and prominent fund -- it is also an indication that the Association is starting to adopt and conform to principles of self-regulation and self-policing.

Lastly, it is worth noting that the Ukrainian government, in contrast with Russia at the same stage of Russia's development, appears to be taking a more active enforcement role. To date, for example, the SPF has suspended and/or revoked the licenses of more than 100 intermediaries for a variety of alleged violations. The GOU has also actively conducted inspections of financial intermediaries and other market participants. While such

¹⁰ The CMMU has proposed to the SPF and the SCSSM that they publish a list of all financial intermediaries that have complied with their periodic reporting responsibilities, and has offered to assist these bodies to prepare and distribute this list. While compliance with periodic reporting requirements is not an absolute indication of trustworthiness, it suggests that the intermediary recognizes the importance and need for disclosure and reporting.

efforts to protect investors are noteworthy, the CMMU has found that the extraordinary extent of these inspections and other regulatory requirements imposed on market participants by the GOU has, in some instances, discouraged apparently law-abiding intermediaries from participating in the market, and may serve as a disincentive for others to enter the industry.

V. CONCLUSIONS

In its sixteen months of activity, the CMMU has consistently provided the GOU with useful and timely market information and analysis that the government would not otherwise develop by itself. Indeed, the SPF and SCSSM have come to rely on the CMMU for information and analysis -- along with assistance on compliance inspections and other matters -- and until these agencies develop their own capabilities to monitor the market and the activities of market participants, the CMMU serves a critically important role, particularly as the Ukrainian capital markets develop and deepen, and market participants become more experienced and sophisticated. Moreover, the Ukrainian professional staff have become very knowledgeable about the Ukrainian capital markets and capital markets issues, and whether they ultimately join the private or public sectors, their experience with the CMMU will enable them to contribute substantially to the further development of the Ukrainian capital markets.

MASS PRIVATIZATION PROJECT SHAREHOLDER REGISTRATION PROJECT

Objective: To develop and implement mechanisms/procedures to insure the efficient, accurate, timely, transparent and standardized transfer and receipt/consolidation of certificate auction, closed subscription and other forms of share sales-generated shareholder lists for individual enterprises from the Ukrainian Center for Certificate Auctions (UCCA), Auction Center Network (ACN), State Property Fund (SPF) and the Regional Property Fund's and to ensure that independent registrars and issuers maintain accurate recording of such lists.

Counterparts: Primary = Issuers, registrars.
Secondary = Professional Association of Registrars and Depositories (PARD)/independent registrars licensed by the Securities and Stock Market Commission (SSMC).
and (vis-a-vis data transfer issues) UCCA/SPF/SSMC.

PW/MPP Team

Technical

Assistance:

Shareholder data transfer-related information technology, audit and related procedures development and implementation assistance.

Tasks:

Information Technology

- Jointly with UCCA/Auction Center Network certificate auction data processing personnel, conduct review of UCCA/auction center network data handling/processing practices regarding shareholders generated by winning bids submitted by trust companies/buyers' associations and the distribution of such data to share registrars and enterprises, beginning with a review of Kyiv Regional Auction Center practices. Make recommendations to UCCA regarding data submission standards for such financial intermediaries by auction centers to reduce problems created for registrars/issuers by erroneous data entry.
- Conduct jointly with UCCA/SPF/registrar SRO shareholder data transfer review leading to agreed upon steps to address data interface problems.
- Review closed subscription (and other types of share sales) shareholder data recording and transmission practices by the SPF/RPF's. Review data receiving and verification practices of independent registrars. Develop jointly with specialists of the SPF and the share registrar industry (via PARD) recommendations to address data recording/transmission problems and to standardize and improve the quality of closed subscription shareholder data as provided by the SPF/RPF's to independent registrars and issuers.
- Develop and implement a standardized closed subscription data transfer format with SPF/RPF official "stamp of approval" on all transferred shareholder lists.

- As required, assist the SPF and the UCCA in developing software enhancements to address the financial intermediary and closed subscription data recording and transfer issues raised as a result of the above-described reviews.
- Advise and assist share registrars, via PARD, with resolution of data consolidation issues.
- Review software/data capture operations of selected number of PARD member share registrars. Conduct testing and performance measurements to ensure industry standards and use of authorized (i.e. non-pirated) software.
 - As required, provide relevant SPF/RPF and UCCA/auction center specialists with training in agreed changes to data collection, processing, distribution and related software for closed subscription and financial intermediary shareholder data processing procedures.

Audit

- Conduct reviews of UCCA, Kyiv Regional Auction Center, other auction centers receipt and distribution of financial intermediary (trust companies, buyers' associations) shareholder data to share registrars and issuers in order to evaluate and improve compliance with receipt and distribution data completion and formatting and timely transfer. Provide training of UCCA specialists to conduct such reviews.
- Conduct reviews of closed subscription shareholder data recording and distribution by RPF's to test compliance with the standards agreed with the SPF. Train SPF specialists to conduct such reviews.
- Train SRO to conduct registrar reviews to insure that SRO software and recording standards for shareholder data received are followed by membership.
- Assist SRO in the development of membership audit guidelines/procedures manual for PARD members' to conduct internal audits for shareholder data collection and maintenance.
- Provide SSMC enforcement specialists with training, via joint auditing, of selected share registrars. Compliance procedures to include reporting requirements, software and related systems maintenance and other areas as agreed with the SSMC.

Procedures/Policy

- Organize a small team of specialists from the Contractor, SPF and SSMC to conducted reviews of selected "blue chip," large enterprises (with > 500 shareholders) of their consolidated shareholder data including verification versus certificate auction and closed subscription records of the SPF and versus the shareholder records of the enterprises' outside registrars. Provide issuers findings to the SPF, SSMC and the registrars' SRO as a means to

improve recording and reporting standards and enforcement of such standards by appropriate agencies and SRO's.

- Develop UCCA/SPF data transfer policies and procedures to address the existing problems of erroneous/omitted shareholder data submitted electronically by trust companies and buyers' associations to the auction center network - and then to the UCCA and RPF's - as a result of incorrect data entry. (Such incorrect shareholder data is then transferred back from the UCCA to the regional auction centers, to the RPF's and finally to registrars and issuers. The trust company/buyer association bidders are responsible for submission of correct/verified data. The problem is an issue with the largest RCCA's where most financial intermediary bids are received and where, given the volume of bids, the auction center is unable to review - and reject for correction by the bidder - erroneous data submissions.)

- Assist the SRO to incorporate shareholder data collection, recording and reporting standards as minimum SRO membership standards and to "rollout" such standards for the share registrar industry.

- Develop with the SRO a mechanism to formally report to the SPF and the SSMC on shareholder data transfer procedural and regulatory violations by the UCCA/auction centers and the RPF's.

- In coordination with SPF and UCCA policy specialists and management, develop policies, procedures and reporting formats to govern financial intermediary (trust companies and buyers' associations) shareholder data reporting and distribution to share registrars and issuers.

- In coordination with SPF specialists and management, develop policies, procedures and reporting guidelines to govern verification, recording and distribution of closed subscription (and other types of sales) shareholder data from the SPF/RPF's to share registrars and issuers. Develop SPF/RPF closed subscription "stamp of approval" procedures whereby closed subscription shareholder data provided to registrars and issuers will contain evidence of SPF/RPF approval in order to avoid future disputes regarding data authenticity.

- In coordination with the SPF and UCCA (and with input from PARD), provide recommendations to the UCCA regarding financial intermediary shareholder reporting standards including recommendations to return bids to intermediaries when shareholder data fields are incomplete/incorrect. Work with auction center specialists to improve reporting by major financial intermediary "worst offenders".

- In coordination with the PW/MPP information technology and audit functions, assist the SSMC to develop procedures and policies governing the implementation of agreed data maintenance and compliance standards for the shareholder registrar industry.

- Utilizing currently available MPP data (from the SPF and the Ministry of Statistics) as well as analyses to be conducted by the PW/MPP team's

Privatization Data Task Force, identify and ascertain the number of privatized enterprises with 500+ shareholders and those with fewer than 500 shareholders.

- While such analyses are being conducted, utilize existing MPP data to estimate, based upon the number of employees of privatized enterprises, the number of enterprises which on average should have more than 500 or more shareholders, i.e. estimate on average how many employees are required to generate 500+ shareholders.

- Advise and assist the SSMC in the drafting of an order and a letter to each enterprise estimated to have generated 500+ shareholders via the MPP, advising the directors of such enterprises that they are legally required to appoint an independent registrar, that they must advise the SSMC as to their appointed registrar or, if the enterprise claims fewer than 500 shareholders, the director must confirm so in writing - and with a list of the enterprise's shareholders.

- In coordination with USAID, USAID's capital markets contractor - FMI, SSMC, the registrar industry and other interested parties, develop shareholder registration policies to be applied to those enterprises with 500+ shareholders which, for financial reasons, have yet to appoint an independent registrar and those enterprises with <500 shareholders.

- Assist the SPF to insure that closed subscription shareholder lists are properly transferred to and maintained by <500 shareholder enterprises.

- Advise the SSMC on creation of an order requiring <500 shareholder enterprises to publicly post (in the enterprise entryway? in the local post office? Saving Bank branch? Regional Auction Centers?) the list of SPF approved closed subscription/employee shareholders. This would require a change in SSMC regulations governing the confidentiality of shareholder information.

- Assist the SSMC, SPF and/or PARD to consolidate and retain a copy (until such time as the enterprise has >500 shareholders) of initial shareholder lists for <500 shareholder enterprises as a means to protect the interests of shareholders of such enterprises.

MPP SHAREHOLDER REGISTRATION PROJECT TEAM IMPLEMENTATION STRATEGY

The main purpose of the Shareholder Registration Project is to protect the rights of shareholders resulting from the primary allocation (sale) of shares of state owned enterprises via different privatization mechanisms.

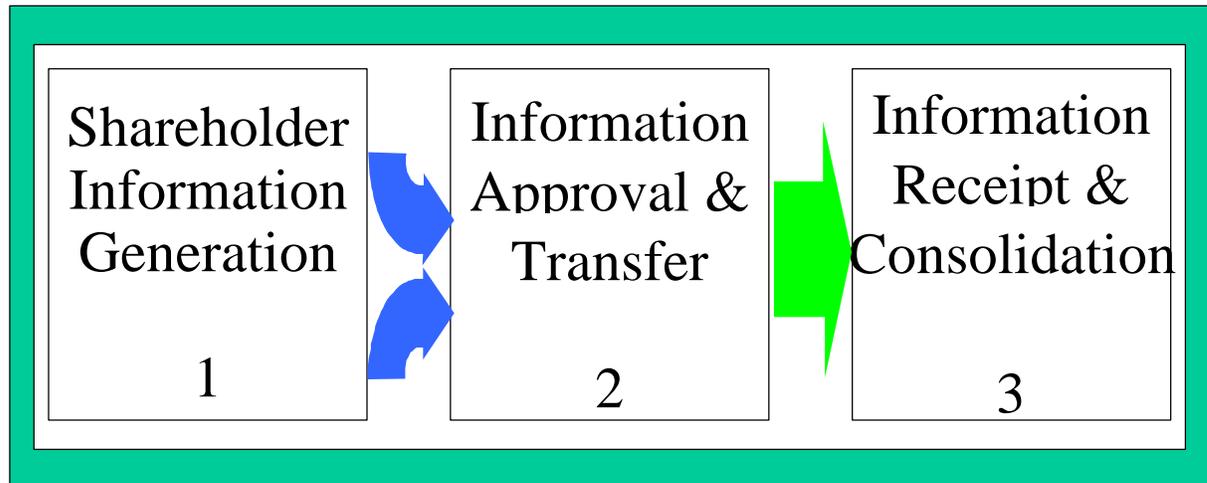
We will advise and assist the SPF/RPFs, UCCA/RCCAs, SSMC/TRs SSMC, PARD to ensure:

- quality and reliability of Primary Shareholder Information generated after each sale of shares;
- standardized Primary Shareholder Information Format and Flow for each share sale mechanism;
- openness, accessibility and publication of Primary Shareholder Information;
- timely and transparent transfer of Primary Shareholder Information from SPF/RPFs to permanent record keepers;
- timely receipt and efficient consolidation and maintenance of the Primary Shareholder Information by permanent record keepers.

Successful implementation of the Shareholder Registration Project Tasks and Deliverables calls for very close cooperation of the main PW MPP functions (IT, Audit, Policy) and constant coordination with USAID and other USAID Contractors.

- We must:
- review current practices used;
 - propose necessary enhancements;
 - assist in implementing the changes;
 - provide necessary training, and
 - review compliance with the enhancements.

Shareholder Registration Project Implementation Strategy



- > Policy
- > Information Technology
- > Audit

ACCOMPLISHMENTS TO DATE

As mandated by the current USAID Task Order (Special Task), the main purpose of the Shareholder Registration Project is to protect the rights of shareholders resulting from the primary allocation (sale) of shares of state owned enterprises via different privatization mechanisms by providing for a transparent and efficient consolidation of the share sales results, i.e. lists of share owners, in shareholder registries maintained by Independent Record Keepers.

On the whole the implementation process of the Shareholder Registration Project may be subdivided into two general Stages, i.e. Stage I - the “Foundation”; Stage II - the “Fine-tuning”.

The main efforts of the SRP team in the Stage I - the “Foundation” - were focused on establishing the appropriate legal and regulatory framework, rendering direct assistance in generating the appropriate shareholder information (*SPF, UCCA*) and obtaining and consolidating (*PARD, Independent Registrars, Issuers*) of the shareholder information as well as raising awareness and coordinating the efforts of the parties involved in the process (*SPF, SSMC*).

Since initiation of the Shareholder Registration Project to date, the bulk of the project tasks were successfully accomplished or are in the final stage of completion (*see attached “Deliverables to Date”*):

- created appropriate legal framework
- introduced standard shareholder information format
- established standard shareholder information and documentation flow
- established monitoring/control system of the shareholder information transfer

The above statements provide evidence that the Stage I - the “Foundation” - was generally completed.

FUTURE ACTION

The main focus of the current Stage II - the “Fine-tuning” - is to continue to provide support to the counterparts in order to ensure that the legal framework and the standards established are followed by the parties involved, and that the shareholder information consolidation indeed takes place.

And, given the new status of our main counterparts, i.e.:

- new “cash” privatization policy (sector specific) of the SPF;
- subordination of the ACN to the SSMC;
- new mandate of the SSMC;
- PARD as an SRO;
- increased role of Depositories and Custodians;
- increased role of Stock Exchanges and PFTS,

the SRP team should provide adequate assistance and support in order to promote and further develop their new functions.

Moreover, the tasks to be implemented during Stage II - the “Fine-tuning” - will require concerted efforts of the main PW MPP functions and, therefore, call for modifications to the SRPT Implementation Strategy, to align it with the new roles of our counterparts.

We propose that we restructure the SRPT, and create the SRP TF - to re-assign the team members to the PW MPP main functions - IT, Audit, Policy.

While maintaining the assigned responsibilities and constant coordination between the SRPT members, this will allow an “interchangeability”, to effectively draw on available resources of the PW MPP main functions for implementation of specific Stage II tasks (e.g. Registrars reviews, SSMC Data Gathering and Processing (*Issuers/Registrars Reporting Databases*) System reviews, etc.).

POST MPP

PARD

Further automation of PARD as an SRO: GroupWare + E-Mail + Document Management + Document Workflow = **Lotus Notes**

PARD/SSMC

Registry/Depository Software Certification System and Laboratory

SSMC

Global Securities Markets Information Network based on ACN

SSMC Operations Automation

Secondary Market Monitoring System

National Depository and Clearing Center

DELIVERABLES

Shareholder Information Transfer

- Drafted the SPF Regulation on the Shareholder Information Transfer from the UCCA to Issuers/Registrars which has been approved and registered with the Ministry of Justice.

Privatization Deposit Accounts

- Drafted the SPF Regulation and SPF Instruction “On Sale of Shares for the Remainders in Privatization Deposit Accounts” which has been approved and registered with the Ministry of Justice.

Quality and completeness of the Shareholder Information

- Created a joint SPF/UCCA/PW working group to research and to propose solutions to problems of quality and completeness the UCCA Shareholder Information.
- Drafted an SPF Order “On introduction of changes to the Regulation on the procedure for submitting applications by financial intermediaries and buyers associations for purchase of shares offered for sale at certificate auctions”.

Closed Subscription

- Drafted the SPF Regulation on Procedures for Preferential Sale of Shares which has been approved and registered with the Ministry of Justice
- Developed a standardized shareholder information format for shareholder data created in the process of Preferential Sale of Shares.
- Upgraded Closed Subscription Software according to the approved SPF Regulation.

Registry Compilation and Introduction of Changes After Each Stage of Privatization

- Drafted and provided to the SPF the joint SPF/SSMC Regulation on Procedure of the Registered Securities Owners Registry Compilation and Introduction of Changes After Each Stage of Privatization.
- Drafted an SPF Order on Standardization of the SPF “Order on Introduction of Changes into the Registered Securities Owners Registries” for all mechanisms of share sale.

Share Issue Registration

- Drafted and delivered to the SPF a letter to the SSMC regarding enterprise problems with the Share Issue Registration and the list of enterprises having problems with the Securities Issue Registration.
- Drafted and delivered to the SSMC a letter to enterprises which sabotage Share Issue Registration threatening them with financial fines, a letter to the TR SSMC regarding improving the Share Issue Registration Process together with a list of enterprises having problems with Securities Issue Registration.
- Drafted and provided to the SPF a draft Law “On Introduction of Changes to the COM Decree #... on State Duty” abolishing the Share Issue Registration State Duty for the state enterprises to be privatized.
- Prepared and provided to the SPF an analysis of possible problems with registration of Share Splits and Shareholders Registration when conducting parallel sales of shares for privatization papers and cash.

AIC JCSs shareholder registry maintenance problems

- Prepared and provided to the SPF an analysis of the AIC JCSs shareholder registry maintenance problems and “peculiarities” and proposed solutions to the problems.

PARD Database

- Developed a PARD’s Members Database and Information System Software.
- Conducted testing and upgraded the PARD information system.

- Provided training to PARD office staff to operate the information system.

PARD Assistance

- IT/Shareholder Registry specialist Svetlana Dereza has been assigned to serve as a coordinator of the PARD's technical committee.
- Assisted PARD in organising a Technical Committee and conducting its first work session.
- Developed and provided to PARD recommendations regarding electronic format of registrar quarterly reports.
- Assisted PARD in estimating and planning hardware equipment needed to set up PARD's office within the framework of the USAID financial assistance program.
- Provided technical support to PARD on configuring PARD's computer telecommunications.

Registry Software Contest

- Established a Technical Working Group, responsible for technical aspects of conducting the Contest and testing and analysis of each of the software packages presented.
- Provided computer hardware, software and other necessary equipment and facilities to conduct the Software Testing at an appropriate technical and professional level.
- Assisted PARD in elaborating the Procedure for conducting the Shareholder Registry Software Contest and Registrars' Information Technology Conference.
- Drafted the following documents, which were used to conduct the Contest: *Criteria for testing Share Registry Software packages; Functional Requirements of the Share Registry Systems; Structure and forms of the Master File ("Technical Documentation"); Test data and test plans; Questionnaires to conduct a survey of IT facilities and software packages used by Registrars;*

Registry Software Certification

- Elaborated and provided to the SSMC and PARD a concept, recommendations and proposals on share registry software certification.

500+ shareholders

- Conducted and provided to the SSMC, SPF and PARD, an analysis of the MPP enterprise database and developed estimates as to how many/which enterprises have more than 500 shareholders and are obliged by the legislation to transfer their shareholder registries to Independent Registrars.
- Assisted the SSMC and its Territorial Offices in preparation of official lists of OJSCs which have more than 500 shareholders and distribution of the joint SSMC/SPF Order and letter to such JSCs ordering them to transfer their shareholder registries to Independent Registrars.

SSMC Training

- Assisted the SSMC to organize and conduct the “State Regulation and Control of the Registered Securities Registry Handling Activities” training seminar for the SSMC Territorial Representations.
- Participated in the seminar and presented an overview of the MPP shareholder information generation and transfer processes; the share registry software market in Ukraine and the results of the PARD's Registry Software Contest.

SSMC Assistance

- Prepared and provided to the SSMC proposals on assistance that can be provided in the framework of the USAID Mass Privatization/Shareholder Registration project:
 - expert assistance on the SSMC Registrars Reporting System

- independent Reviews and Evaluations; Independent System/Acceptance Testing
- assistance in inspections of independent registrars on privatization-related issues
- assistance in setting up the Share Registry Software Certification System

RESULTS OF THE LVIV STRATEGY MEETING

Implementation Idea #1: IMPROVE ACN INFORMATION

Status: **COMPLETED**

Implementation Idea #2: CREATE WEB SITE FOR MPP INFORMATION

Status: **IN PROGRESS** (WWW Task Force)

Implementation Idea #3: SPONSOR TENDER FOR SHARE REGISTRY SOFTWARE

Status: **IN PROGRESS** (Analysis)

The preliminary analysis of issuers with less than 500 shareholders has been completed and reviewed by MPP SRPT members. As a result, the methods used for estimates will be adjusted and additional data sources will be added. The revised final version of the analysis is expected to be completed by the end of October 1997.

Implementation Idea #4: SUPPORT SOFTWARE CERTIFICATION

Status: **IN PROGRESS** (Pending response from PARD and SSMSC)

The proposals to assist in setting up a certification system and to provide related consulting services have been elaborated and submitted to the appropriate counterparts (SSMSC and PARD), both of which expressed a strong interest in the collaboration and are currently preparing the framework for such cooperation. In addition, PARD and SSMSC would like to jointly conduct a second SRS Software Contest in February or March 1998, calling it *The Best SRS Product 1998*.

Implementation Idea #5: ESTABLISH INFORMATION NETWORK for REGISTRARS and DEPOSITORIES

Status: **CANCELLED**

Implementation Idea #6: INITIATE DEBATE: REGISTRARS vs. DEPOSITORY

Status: **CANCELLED**

The concept of the securities market infrastructure is being radically changed today, at the official level. The emphasis is shifting from independent registrars to a national depository system with a Central Depository. The pending *Law on National Depository System and Electronic Circulation of Securities* will limit the role of registrars to deal only with tangible (materialized) issues of securities. In cases of electronic (dematerialized) securities issues, the *national depository system* (represented by either local depositories or a Central Depository) will be the permanent record keeper of the share registry.

The Securities and Stock Market State Commission (SSMSC) has also initiated the process of elaborating a concept of a *Global Information Network for the Securities Market*.

Implementation Idea #7: CONDUCT TRAINING SEMINARS

Status: **COMPLETED**

Implementation Idea #8: IMPLEMENT PARD INFORMATION DATABASE
Status: **COMPLETED**

MASS PRIVATIZATION PROJECT

FINAL PHASE TASK ORDER:

KEY EVENTS/KEY OUTPUTS

APRIL 1997 PROGRESS REPORT

Preceding the progress reports, we have provided an analysis as to the outlook for the MPP over the near term and proposals as to how the MPP might again be accelerated from the stagnated pace (in terms of quantity and quality of enterprise share packages being offered in certificate auctions).

On April 15, 1997, implementation of the Final Phase of USAID technical and financial assistance for Ukraine's Mass Privatization Program began. The MPP team believes that two conditions are critical to the "successful completion" ("successful completion" means the offering of all share packages of all enterprises approved for privatization - including those of Ukraine's largest and most attractive enterprises) of the mass privatization program by early next year: a framework by which the GOU can accelerate and streamline privatization in 1997/98 and the political will to utilize the established framework to actually and successfully complete the process.

The Presidential Administration, the Cabinet of Ministers and the Parliament have been at loggerheads over the past several months as a result of conflicting visions for the future course of privatization - as exemplified by the extended debate, vetoes and final enactment by the Verkhovna Rada of the Law on Privatization which, among other things, subordinates the State Property Fund to the Rada; the on-going debate between government and the Rada as to which enterprises are of "national security" and "strategic" importance and thus to be excluded from privatization or in which the state is to retain large shareholdings; the failure of the Rada to clarify the use and continued distribution beyond mid-June of Compensation Certificates; the rejection by the Rada of the President's nominee for State Property Fund Chairman; and the failure of both the Rada and the Presidential Administration to enact/propose a Program of Privatization for 1997.

In response to issues and recommendations presented in the joint donors' letter on the restoration of Ukraine's privatization program, sent to Prime Minister Lazarenko on April 7, 1997 and signed by the U.S. Ambassador and the chief representatives in Kyiv of the World Bank, the IMF and the European Commission, the President issued a Decree (and introduced a corresponding draft Law to the Rada) on the 1997 Privatization Program on May 6, 1997.

The President's Decree and proposed Law provide a basis and framework for accelerated and streamlined completion of the mass privatization process in 1997. While the Rada may fail to enact the President's proposed Program, the Rada is currently debating an alternative version of the 1997 Privatization Program. And while less aggressive than the President's version (which itself contains a number of questionable proposals), the version under debate does provide a framework for a return to an accelerated process for the remainder of 1997. The President's version incorporates many of the recommendations made by the MPP consulting team and the donor community to the State Property Fund.

Our analysis of the two versions of a "1997 Privatization Program" is included below as is an analysis of the proposed "Amendment to the Law on Compensation" which would allow for continued and increased distribution of Compensation Certificates. It is

important to note that both versions of the 1997 Program can be interpreted as addressing and laying the foundation for the extended use of Compensation Certificates as a major vehicle for efficient and accelerated share sales and for the offering of the shares of Ukraine's largest (including Group D) enterprises in certificate auctions and their accelerated privatization. The President's version of the Program also clearly implies that the generation of budget revenues is not a primary objective of privatization but rather that mass privatization has as its objective ownership transfer from the state to the private sector.

The adoption of a 1997 Privatization Program by the Rada is an important step forward toward effecting a turnaround in the mass privatization program from the slower pace of the first four months of 1997. However, no matter what version of the 1997 Program is finally adopted, political will on behalf of the GOU (the State Property Fund, the Presidential Administration, the Cabinet of Ministers and the regional administrations) will be the most critical factor in the acceleration and successful completion of Ukraine's mass privatization program. In this regard, the statements of the Prime Minister and the management of the State Property Fund - as they appear in the press releases quoted below - are very positive responses to the issues raised by the donors. The statements confirm the intention of the GOU to:

- "Privatize approximately 8000 medium/large enterprises by the end of 1997 including 3000 this year"
- "Increase the number of attractive enterprises offered in Compensation Certificate auctions"
- "Complete the privatization of large enterprises by the end of 1997 as a means of removing one of the major barriers standing in the way of attracting foreign investment."

In addition to political will, the GOU requires continued and intensified technical assistance to develop the procedures for and assist the largest enterprises in the accelerated completion of the preparation and sale of shares. In this regard, the USAID/MPP consulting team, to meet our objectives for 1997, must begin to provide strategic and policy assistance directly to the Chairman of the State Property Fund and must secure the clear agreement of the Chairman and management of the State Property Fund for our 30 enterprise preparation specialists to begin providing assistance to the largest and most important of those "Centralni Apparat" enterprises (including Group D enterprises) approved for privatization.

The following paragraphs provide a review of the framework for a turnaround in the mass privatization program including:

- The President's proposed 1997 Privatization Program,
- A comparison of the President's version with the version (Rada Deputy Ugarov's) of the 1997 Program currently being debated by the Rada,
- Questions/issues raised by the President's version,
- The proposed (by Deputy Ugarov) Amendment to the Compensation Law regarding distribution of Compensation Certificates,
- and news releases quoting the Prime Minister and SPF management as supporting the privatization initiatives proposed by the donors and their consultants.

FRAMEWORK FOR A TURNAROUND

PROPOSED 1997 PRIVATIZATION PROGRAM

An analysis of key terms of the Presidential Decree of May 6, 1997 on the 1997 Privatization Program follows:

Positive Aspects of the Presidential Decree

(in order of their appearance in the draft Program)

- The Program does *not* promote revenue generation as a goal of the privatization program.
- The Program has as a priority the sale of shares of groups B, C and D enterprises for privatization and compensation certificates thus legalizing compensation certificates as a privatization means of payment in auctions, preferential sales and sales to management..
- The Program stipulates that all share allocation plans approved before 1997 must be fulfilled in 1997.
- The Program specifically stipulates that enterprises using explosives and dangerous substances in their production can be privatized in accordance with standard privatization procedures, thus greatly reducing the potential for expansion of the negative list. (The Privatization Law states that such enterprises can be excluded from the privatization program.)
- The Program requires that packages of enterprise shares which have been retained by the state without appropriate Cabinet of Ministers' approval must be sold. The share allocation plans of such enterprises are to be revised in accordance with the requirements of the Program within 2 months of the Program's adoption.
- The program stipulates that the state can retain share packages of 26% or 51% in specific enterprises but only via the Cabinet of Ministers which must make a determination that each such enterprise is of importance to national security. A list of such strategic enterprises is to be compiled by Cabinet of Ministers. (This condition is positive only in the sense that the various ministries may find it difficult to reach agreement on such a list, thus perhaps keeping the list small.)
- However, the state can retain share packages for a maximum of only two years. Such share packages can be sold earlier. Retention of state shareholdings beyond the two year period requires a redetermination by the Cabinet of Ministers.
- The Program establishes the following range of quotas for the sale of shares for privatization and compensation certificates for medium and large enterprises. The upper limits exceed those established by Presidential Decree #699:
 - 80% to 100% of the shares of each Group B enterprise must be sold for certificates
 - 50% to 75% of the shares of each Group C enterprise must be sold for certificates
 - 5% to 40% of the shares of each Group D enterprise must be sold for certificates.
- In certain cases, the SPF is given the authority to reconsider established quotas by a decision of the SPF management.
- Sales of shares for cash can be conducted only following preferential sales to employees and management and sales for PPC and CC within established quotas are completed.
- Payment for shares sold via preferential sale can be effected with PPC's, CC's and cash in any proportion.
- Unfinished construction objects may be sold along with their land to local buyers. Such land plots may be leased by foreign buyers.
- Foreign investors are allowed to use compensation certificates as payment for shares offered in compensation certificate auctions.
- Sales of majority share packages to strategic investors are allowed only if the above quotas of share sales for PPC's and CC's have been met.
- The Program provides a number of measures designed to safeguard shareholder rights during the privatization process (e.g. prohibition of new share issues, prohibition on the sale of enterprise assets until the share allocation plan is fulfilled, prohibition of any limitations on the sales of shares purchased during privatization, etc.).

- Any decision to transfer the shares of an enterprise to a holding company requires a 1/2 majority vote of the shareholders.
- All decisions adopted by the SPF under the Program are binding for all branches of executive power, both central and local.
- The Program requires that share allocation plans when fulfilled be published in the SPF bulletin and central/local press.

(Note that many of the above aspects of the President's 1997 Program were proposed by the USAID/PW team and the donor community via the SPF - although we proposed higher minimum quotas for share sales for certificates.)

Alternative (Ugarov version) 1997 Privatization Program under consideration by the Verkhovna Rada:

Mr. Ugarov, head of the Rada economic policy committee's subcommittee on privatization, has proposed an alternative 1997 Privatization Program which is currently undergoing consideration by the Rada. The Ugarov proposal was recently passed in its first reading by the Rada and will have its second reading during the week of May 12.

While the Ugarov version is acceptable in terms of providing a framework for mass privatization in 1997 and while it contains a number of the positive proposals similar to those in the President's version, it also is not as aggressive as the latter and contains several conditions which could be interpreted as negative for accelerated mass privatization this year:

- The Ugarov version has as a goal of the 1997 Program cash revenue generation for the state budget.
- No stipulation that enterprises using explosives and dangerous substances in their production process can be privatized.
- No requirement for the sale of share packages retained by the state without Cabinet of Ministers' approval.
- A requirement that the Cabinet of Ministers compile a list of enterprises to be sold for cash.
- No time limit on state retention of shares.
- No authority given to the SPF to modify share allocation plans in special cases.
- No requirement that cash sales must come only after the fulfillment of preferential and certificates auction share sales quotas.
- No flexibility provided for payment for shares in any combination of certificates and cash.
- Unsold shares (i.e. those leftover following sales as required by an enterprise's share allocation plan) may be retained by the state.

On the other hand, the Ugarov version provides for fixed minimum quotas for the sale of shares for certificates rather than a range of quotas. The Ugarov version sets forth the following quotas:

- *not less than 70%* of the shares of each Group B enterprise must be sold for certificates
- *not less than 50%* of the shares of each Group C enterprise must be sold for certificates
- *not less than 20%* of the shares of each Group D enterprise must be sold for certificates.

Issues raised by the President's Decree on the 1997 Privatization Program

The most critical issues are: Which version (or a compromise version) of the Privatization Program is likely to be adopted by the Rada and when will it become effective?

There are five alternatives:

1. Within one month (of the President's Decree of May 6) the Rada approves the Ugarov version;
2. or within one month the Rada approves the President's version (in the form a draft law presented to the Rada when the Decree was signed);
3. or within one month the Rada votes by a $\frac{3}{4}$ majority to reject the President's version (leaving the Rada to then approve the Ugarov or another version of its own - and further delaying the adoption of a privatization program for 1997);
4. or within one month the Rada votes but fails to generate $\frac{1}{2}$ majority to reject the President's version (the latter would then come into force);
5. or the Rada fails to take a vote on the President's version within one month, in which case the President's version would become effective.

Another shortcoming of both the President's and the Ugarov versions are the lack of overall medium/large scale privatization targets (i.e. *number of enterprises to be privatized by year end*). Both versions call for 1440 new Group B,C and D enterprises to begin preparation for and complete privatization in 1997. However, the draft programs do not indicate how many enterprises in total are to be privatized - including those already partially or fully privatized, those prepared for privatization in 1996 which have yet to begin privatization and the 1440 new enterprises.

SPF officials have stated that 5100 Groups B, C and D enterprises have been privatized since the beginning of 1995 and that 1400 are in the process of privatization. These 6500 - along with the 1440 - will allow the SPF/GOU to reach the 8000 +/- target by the end of 1997, according to SPF management. However, this overall target numbers of enterprises target is not incorporated into the proposed 1997 programs.

In addition, while setting forth share sales quotas for certificates, neither version requires that minimum *overall depth of privatization targets* be met. Proposed donor conditionalities call for 70% or more overall of the shares of 8000 Group B, C and D enterprises to be privately held by yearend, i.e. approximately 3000 new enterprises should be 70% or more privatized (in private hands) by yearend. The proposed 1997 programs do not establish overall depth of privatization targets.

If the SPF decides to reach only the lower limits of the established quotas for shares sold for PPC's and CCs, then the SPF/GOU will be very unlikely to attain the 8000 enterprises/70% of each privatized target by the end of 1997.

Another issue raised by the President's (and the Ugarov) versions of the program involve the list of enterprises of national importance in which the state may retain large shareholdings. Until approved, the sale of state-owned shares in these presumably major enterprises will not be sold and the SPF may miss the opportunity to employ the streamlined privatization process introduced by the program.

One of the key factors in the success of medium/large enterprise privatization in 1996 was the introduction of valuation methodology which does not require the indexation for inflation of fixed assets when determining the statutory capital of each new JSC. This measure enables employees and management of each enterprise to acquire more shares and to accelerate the sale of shares via certificate auctions. It is unclear in the two versions of the 1997 program whether this effective approach will be continued.

Open cash auctions (i.e. shares sold to the highest bidder) as a method of share sales is not mentioned in the President's Program nor is the sale of shares through the OTC system, thus

indicating that the Ukraine Stock Exchange and the auction center network may obtain a monopoly right to sell shares for cash.

Lastly, although the Program legalizes the sale of shares for CCs, it does not extend CC distribution beyond June 30 and does not address the issue of the impact of CC collection on depositors' savings account balances. The first issue can be resolved through a Presidential decree (or decision of the Rada) for formally extended CC distribution until at least the end of 1997 and the submission by the President for the Rada's approval of amendments to the Law on Compensation, as discussed below.

PROPOSED AMENDMENT TO THE COMPENSATION LAW

The Compensation Certificate compensation scheme proposed by Rada Deputy Ugarov, actively supported by Sberbank Chairman Kolesnikov and endorsed by the Chairman of the SPF (in lieu of the earlier proposal of the former SPF Chairman for "parallel" compensation) is as follows:

1. The indexation coefficient for calculating the number of CCs a depositor is entitled to receive is 2,200 Karbovantsy per 1 Rouble of deposit as of 01/01/92. This coefficient was established by Presidential Decree #698 in November 1994.

For example, a person who had 1000 roubles on deposit as of January 1992 was entitled to $1000 \times 2200 = 2.2$ mln Kbv. This sum is compensated with 3 Compensation Certificates with a face value of 1 mln Kbv each (following upward rounding). *This is equivalent to 30 Hryvnas nominal value (or 21 Hryvnas, or 3 Hryvnas per CC, at current market prices for CC's).*

This coefficient did not change since 1994 and does not reflect inflation since that time.

2. The compensation coefficient, established for cash compensation in the Compensation Law passed by the Rada in November 1996, takes into account inflation for the 1992 - 1996 period. The cash compensation coefficient is 1.05 Hryvnas per 1 Rouble on deposit as of 01/01/92.

For example, a person who had 1000 Roubles on deposit in January 1992 is now entitled to $1000 \times 1.05 = 1,050$ Hryva (or 105 mln Kbv)

Thus, CC compensation (30 Hryvna nominal value) is less than 3% of overall cash compensation (1050 Hryva) as per the terms of the Compensation Law.

3. Ugarov's proposal is to subtract the nominal value of CCs already collected (30 Hryvna) from the total cash compensation (1050 Hryvna) package. Thus, each depositor is entitled to a package of 3% compensation in CCs and 97% in future cash. Put another way, citizens who collect their CC's only forfeit 3% of their overall compensation package (and are entitled to any future cash compensation, however unlikely).
4. The proposed amendment must of course also extend CC distribution to at least the end of 1997.

We consider this approach to be an acceptable compromise.

- *Of course, some individuals will be concerned about the prospect of losing 3% of their compensation package.*
- *However, most citizens have had enough experience with government promises of "future compensation" (e.g. most citizens have had firsthand experience with non-payment of wages and pensions by the government to be skeptical of such promises made by the Rada.)*

- *In other words, most citizens are savvy enough to understand that a nominal sacrifice of 3% is a small price to pay for immediate compensation versus future promises. At today's market prices for CC's, a 3% "paper loss" translates into only 9 Hryvnas out of a total "potential" compensation package of 1050 Hryvnas. Put another way, a citizen can earn 21 Hryvnas today versus promises of future compensation.*

PROJECT TEAM: PRIVATIZATION STRATEGY ADVISORY TEAM
("PSAT")

Progress Report

April 1 - April 30, 1997

Key Events/ Key Outputs

PRIVATIZATION STRATEGY ADVICE

- Drafted and presented at the Lviv off-site PW Team Session the PSAT Strategy Paper on the new Task Order' implementation.
- Provided comments on drafts of 1997 Privatization Program prepared by Ugarov and SPF/Presidential Administration (to be introduced by Presidential decree).
- Developed and submitted to the SPF draft concept of the consequence of share sales based on the quotas of sales for PPCs and CCs established by the Presidential version of 1997 Privatization Program.
- Based on the approved version of the Concept, corresponding SPF Order on of the consequence of share sales in 1997 was drafted and submitted to the SPF.
- On the request of SPF Acting Chairman prepared analytical / statistical materials on the course of privatization based on the available certificate auctions results, drafted analysis of the issues to be resolved in order to streamline privatization and drafted list of measures undertaken by the SPF in response to the Donor's letter.
- Participated in drafting of the set of analytical documents on the present stage of privatization in Ukraine for USAID debriefing of Mr. Morningstar during his visit to Ukraine.
- Prepared for the USAID the list of issues to be discussed at their meeting with the SPF Chairman.
- Participated at the meeting of donors and consulting organizations and companies with the SPF acting Chairman.
- Developed concept of regional cash sales (as opposed to the UCCA's complicated scheme of National sales) of leftovers of shares after completion of sales for certificates, and discussed this Concept at the working group meetings, set by SPF to develop cash sales procedures.
- Discussed with the SPF Department of Management of the State Shares possibility of providing analytical assistance to the Department.
- Participated in the sessions of the working group on the drafting the so called Law on Privatization of the Strategically important Companies.
- Joint SPF/NBU Regulation on Settlements for Purchased Privatization Assets has been registered by the Ministry of Justice.

- Finished drafting of two new “step-by-step” guides. The guides were reviewed by appropriate counterparts and approved: the Guide on Inventory During Privatization -by the SPF (Valuation Department); the Guide on registration of share issue -by the SEC.

PROBLEMS IDENTIFIED, OPEN ISSUES REQUIRING DECISION

- Privatization Program final approval is the most important pending issue crucial for the success of privatization.
- The CC problem is still pending especially taking into account that CC distribution period expires by July 1st. Decision is to be taken to extend distribution at least till the end of the year.
- SPF approval of the Procedure for Share Sale for Remainders on Depository Accounts is still pending.
- Decision on the Concept of cash sales and the level of PW involvement in its implementation (if UCCA unnecessary complicated scheme is approved) is to be taken.
- To streamline privatization of AIC companies it was preliminary agreed with the SPF to develop corresponding concept of order of share sales of AIC companies.

Progress Report

April 1 - April 30, 1997

Key Events

- The information note for the 28th PPC auction was published by the SPF.
- The 14th auction for CC was launched by the SPF.
- The Auction Commission approved the results of the 26th PPC auctions. 335 share packages were offered. Auction results approved for the 332 share packages. The number of winning certificates was 285,942 which is the lowest number since 8th PPC auction (09.1995). As many as 154,365 (or 54%) of these PPCs were accumulated by top 10 biggest enterprises' share packages.
- The Auction Commission approved the results of the 11th CC auction. The number of collected CCs - 323,544 is the lowest for the all CC auctions. This can be attributed to the number of new auctioned share packages and the value of the auctioned shares, which were also the one of the lowest. 175,714 CCs (or 54%) of all CCs were accumulated by top 10 biggest enterprises' share packages. Open JSC "Melitopol Compressor", a central apparatus enterprise located in Zaporizhja oblast, gathered 48.462 CCs. 9,43% of its statutory fund was sold at a price 24.21 times the nominal price.

Key Outputs

- Assisted SPF to compile and verify the information packages for the 28th PPC auction (May). A total of 249 (67 less than in the last auction) share packages have been prepared, including 126 (45 less than in the last auction) share packages of new enterprises. 90 share packages were sent but not published because of the new SPF requirements as for the auctions information flow. The average size of offered packages is 19.48% of the statutory fund is one of the lowest.
- Assisted SPF to compile and verify the information packages for the 14th CC auction (May). A total of 172 (55 more than in the last auction) share packages have been prepared, including 138 (61 more than in the previous auction) share packages of enterprises that never participated in CC auctions. The average and weighted average sizes of the proposed share packages as of the statutory fund are highest for the last 5 CC auctions.
- Created software for data collection, collected in electronic format and began to verify the list of monopolistic enterprises received in paper form from the Anti Monopoly Committee.
- Created first versions of two databases in order to collect data on share allocation plans (SAPs) from mass media and other available means.
- Collected in electronic format all SAPs published by the date from "Investment Gazette", EE daily and IntelNews.
- Prepared analytical notes on offered share packages for of PPC A28 and CC A14.
- Identified and reported to the SPF the discrepancies in the data on statutory funds and group of the enterprises for some privatized enterprises.
- Prepared analysis on Share Packages leftovers available after PPC and CC auctions for the cash sales.
- Finalized the AIC enterprises share allocation plans analysis.
- Advised on and assisted in implementation of the new information format for electronic version of the "Investment newspaper", which contains data on certificate auctions, share allocation plans, etc.
- Assisted SPF to verify the list of companies to be privatized by RPFs in 1997 and other lists of enterprises.

- Provided SPF with electronic form of verified list of companies to be privatized in 1997 with PW's comments.
- Corrected together with SPF the mistakes found in the list of companies to be privatized in 1997 during verification.
- Updated privatization data on companies that are privatized according to individual plans.
- Assisted in installation of the system to track the approval of SAPs of AIC enterprises at the Cabinet of Ministers.
- Developed and integrated into the privatization reporting system the reports on auctioned enterprises' "preparation body". Reports show what privatization body (SPF or RPFs) was responsible for preparing an auctioned enterprise for the share sale process.
- The SPF consultants continued to provide general assistance to their assigned departments.
- Updated the auction statistics files on the office network with the results of 26th PPC auction and 11th CC auction and the list of share packages offered on 28th PPC and 14th CC auctions.
- Updated the PPC and CC distribution statistics on the office network.
- Fulfilled analysis of the available data sources in order to compile the Group D enterprise list.

Open Issues

- Lack of a formal agreement between SPF, PW and USAID defining the information access policies with regard to privatization related information maintained by the SPF.
- Compiling the lists of Group D enterprises and "large" enterprises (with fixed assets value over 170 mln UAH) on the basis of available sources of information.
- AIC enterprises privatization stages analysis.
- MinStat data reliability analysis.
- Completion of analyze the feasibility of the cash sales of auction share leftovers.
- Completion of the list of enterprises for the pilot cash auction.

Progress Report

April 1-April 30, 1997

Key Events

- Implemented functional reorganization of the Enterprise Preparation Team in light of the new task order objectives, whereupon the Team's structure will incorporate the Central SWAT Team, Regional SWAT Teams and Privatization Newsletter Team.
- Implemented geographical reallocation of the Team's regional staff with aim of bringing the allocation of regional resources in accordance with location of the country's quality enterprises. According to the reallocation scheme, the following correlation between the numbers of enterprises and regional staff has been established:

Region	# of Enterprises Subject to Privatization in 1997 (%)	# of Enterprises of Centralny Apparat subject to Privatization in 1997 (%)	# of Regional Staff After Reallocation (%)
West	23%	16%	17%
Center	22%	24%	17%*
South	12%	12%	13%
East	17%	20%	22%
South-East	15%	21%	22%
Pridneprovsky	11%	7%	9%

*Central Region is also covered by Central SWAT Team

- Commenced direct technical assistance to 2 more "Group D" enterprises: Krasnoluchensk tool-building plant in Lugansk oblast and Azov Sea Shipping Company in Mariupol', Donetsk oblast.
- The SPF offered its 7,444th share package for sale on 28th PPC Auction (April) and increased the total number of new enterprises which offered shares for PPC Auctions to 4,734.
- The SPF offered its 2,681st share package for sale on 13th CC Auction (April) and increased the total number of new enterprises which offered shares for CC Auctions to 2,282.

Key Outputs

- Assisted RPFs to prepare 249 enterprise packages for the 28th PPC Auction. Of these, 126 represented enterprises which had not yet participated in PPC Auctions.
- Assisted RPFs to prepare 172 enterprise packages for the 14th CC Auction. Of these, 138 represented enterprises which had not yet participated in CC Auctions.
- Completed phase-outs of Kyiv and Odessa REPP projects. Meetings with respective RPF management have been held, final REP teams' reports have been presented and discussed and directions for future cooperation with said RPF's have been agreed upon. Letters of gratitude have been presented to the REPP members by Kyiv and Odessa RPF.
- Completed inventory procedure at the "Group D" enterprise "Legmash" in Chernivtsi.
- Completed privatization plan and statutory documents for the Central Apparat Group D enterprise "Centrolit" in Odessa.
- Obtained principal agreement of Donetsk RPF to assist a "Group D" enterprise "Ukrzync" in Donetsk oblast.

- Continued to provide direct technical assistance to 18 privatizing enterprises of Group C nationwide, including preparation of valuation act - 12, share allocation plan - 3, corporate charter - 2, share issue registration package - 3.
- Drafted Part II of the AIC Step-by-Step Guide for “Khib Ukrainy” enterprises. The Guide describes the procedure for privatization of leased enterprises belonging to “Khib Ukrainy”.
- Prepared a memorandum for USAID analyzing the current state of privatization pipeline, outlining the problems and offering solutions on resolving the pipeline problems.
- Prepared an automated express-analysis system of privatizing enterprises’ economic status to be used in preparation to privatization as a part of privatization plan.
- In cooperation with the ACN Team participated in preparation and negotiation of the Memorandum of Understanding between PW and the UCCA on UCCA/RACN involvement in enterprise preparation. Provided input in planning of UCCA/RACN enterprise preparation activities.
- Distributed 111 Property Valuation and 90 AIC Step-by-Step Guides during the reported period to privatizing enterprises nationwide.
- Continued distributing recommendations/standard documents resulting from the experience gained in the course of REPP activity to the other regions of the country through the Team’s regional staff.
- Developed the new Team’s strategy for the new task order and presented it at the team leaders strategy meeting.
- Participated in the donors meetings and coordination meetings with IFC and Public Education Contractor.

Open Issues

- Absence of a permanent Chairman of the SPF which complicates the process of institutionalizing the Team’s direct technical assistance to quality enterprises.
- Delays in final adoption of the 1997 Privatization Program. This issue causes procrastination of making decision on privatization by privatization bodies.
- Lack of enabling acts for the Law of Ukraine on Privatization of Property of State Enterprises.

Progress Report

April 1 - April 30, 1997

Key Events

- ACN's transformation into closed joint stock companies stalled due to the SPF delaying approval of their statutory documents.
- Continuation of the trend over the last several months whereby certificate auction activity has been declining.
- Participated in Strategic Management Meeting to discuss new initiatives and implementation for tasks under the new task order. Presented strategic plan for IT, Audit and UCCA group under the ACN Team during the Meeting.
- Started work under new task order.
- ACN started to operate under performance based financing agreement .
- Contractor "Infocom" completed installation of HUB satellite station.

Key OutputsACN Consulting/Certificate Auction Support

- Concluded Memorandum of Understanding with the ACN for cooperation and sharing resources during enterprise preparation activity undertaken by the parties. The ACN and PW, when participating in preparation of the enterprises for privatization, will make their experts available for the other party's activities, if needed.
- Provided advice to the ACN Management, including Regional Auction Centers Directors, on the requirements of the new Final Phase Financing Agreement and peculiarities of managing the ACN in the performance based financing environment. Proposed strategies to ensure effective ACN functioning.
- Provided \$250,000 to the ACN through the UCCA as a prepayment of their activity in April 1997 as stipulated by the Final Phase Financing Agreement. The prepayment will be adjusted for each specific RCCA after the first round of evaluation scheduled for the middle of May 1997.
- Visited several regions to determine cost and proper recording of USAID equipment located in RCCAs in conjunction with the joint stock restructuring. Regions are as follows: Chernivtsi, Ivano-Frankivsk, Zakarpattia, Lviv, Volyn, Rivne, Ternopil, Khmelnytsky, Zhytomyr, Sumy, Kharkiv, Lugansk, Donetsk. Limited procedures were performed by the joint team consisting of PW IT, Audit and ACN representatives. The visits will cover the remaining RCCAs during May and June 1997.

ACN Systems Support

- Routine maintenance, amendment, and user guidance have been undertaken for the various live systems including CC and PPC bid collection and auction processing systems, shareholders database.
- Implemented additional reports into auction calculation software in order to present information to UCCA management, which serve as the basis for ACN performance evaluation as stipulated in the new financing agreement.
- Started work on plan to transfer responsibilities for software maintenance from PW IT team to PW counterparts. UCCA agreed to accept these responsibilities.

- By UCCA request, implemented into the Compensation Certificate Auction System a feature with report closed internal accounts.
- Satellite station installed in UCCA; tested connection with Infocom HUB station.

Monitoring ACN Activity

- Continued to monitor the performance and financing of the Bid Reception Site (BRS) Network which continued to cover 97% of the Raions in Ukraine and consists of 2,086 permanent, 166 temporary and 23 mobile sites. During the reported period, honored 26 invoices presented by BRS providers for 26th PPC Auction (March 1997) for a total of 8,302 PPCs collected and 28 invoices for the 11th (February - March) CC auction for a total of 507,340 333,430 UAH in CCs collected. This represents 2.6 times decrease in the BRS Network activity compared with the previous PPC Auction and 52% increase compared with the previous CC Auction. Based on the Final Phase Financing Agreement no further BRS payments will be made. The ACN will cover BRS services out of the financing provided based on the ACN's performance.
- Coordinated with the UCCA and SPF Control Departments regarding joint audits; specifically, the Kyiv RCCA audit.
- Reviewed and finalized draft audit programs according to new task order objectives as well as compliance checklists and other efficiency points in preparation of audits during the new task order period.
- Performed standard review of accounting documentation and internal controls at the Kyiv RCCA. Visit is in progress and is currently being performed jointly with UCCA Control Department representatives. SPF individuals were invited to attend visits but were unable to perform joint audits due to time and resource constraints.
- Performed first technical review of Kmelnivtsiy RCCA Report of Findings and final technical review of Lviv RCCA Report of Findings.

Shareholders Database Support

- Through the newly adopted financing rules, encouraged the ACN to deliver electronic copies of share registry information created as a result of the 1996 certificate auctions directly to the share issuers and/or their registrars.
- Mediated in holding a forum joined by the representatives of the SPF, ACN, PARD in order to integrate their efforts regarding share registry information exchange.
- Met internally with Share Registry Project team to discuss upcoming seminar to be conducted in conjunction with FMI in mid May. Determined appropriate topics for audit representative to discuss during the seminar and began preparing for the seminar.

Internal Support

- Maintenance has been undertaken for office hardware and software systems, including repair work for laptops, computer antivirus software installation, office E-mail system maintenance.
- Purchase list was prepared for first stage of project hardware upgrade.

Problems identified, open issues requiring decision

- Awaiting USAID's final decision regarding the conclusion of the MoU between the SPF and USAID on their cooperation with regard to Mass Privatization activities, which will also cover ACN financing.
- Number of new enterprises as a target for the ACN performance evaluation for the months beyond April 1997 needs to be defined by USAID in coordination with the SPF.
- ACN reported damaged printers in 4 regions.

Currently In Progress

- Kyiv RCCA procedures.
- Finalizing outstanding reports from the previous task order period and including these findings in the Summary Report of Findings.

Progress Report

April 1 - April 30, 1997

Key Events and Outputs

- Participated in the Conference of Professional Association of Registrars and Depositories (PARD) to discuss Information Technology (IT) issues in the registrar industry, and to present the results of the Share Registry software competition.
- Participated in the third General Meeting of PARD members, at which Price Waterhouse, FMI, and USAID presented their views and opinions regarding PARD's future activities, and PARD's board of directors discussed common problems faced by share registrars.
- Conducted a meeting of the Shareholder Registration Project Team (SRPT) to discuss share registry issues, and the team work plan. The meeting focused on planning a training seminar for the Securities and Stock Market Commission (SSMC), to be held in May 1997, and to provide training for employees of the Territorial Representations of the SSMC on issues of Shareholder Registry maintenance.
- Conducted a series of meetings with the State Property Fund (SPF) and Ukrainian Center for Certificate Auctions (UCCA) to discuss quality of auction data, specifically as a result of the threat of lawsuits against the SPF by registrars and issuers and agree on improvements.
- Met with FMI to discuss the SSMC training seminar for registrars, and to agree on joint cooperation between FMI, PARD, and PW in conducting the seminar.
- Initiated and participated in the meeting of PARD's Legislative and Registrars Committees to discuss the draft SPF regulation on Shareholder data transfer, and specific Shareholder information problems.
- Initiated and participated in the meeting with UCCA, SPF and PARD to discuss the problems with shareholder registry data provided to independent registrars and to agree on establishing an official mechanism for Registrars to report and solve problems with Shareholder Information received.
- Conducted a series of meetings with the SPF and the SSMC representatives to finalize the Regulation "On Shareholder Information Transfer to the SPF and Issuers". The final draft of the Regulation was signed by all interested SPF/UCCA departments and submitted for approval to the SPF Chairman.
- Met with Messrs. Boiko, Golovko, Lisovy, Bovkun (SSMC) to agree on the date and program of the joint FMI/PW seminar for the SSMC's Territorial Representation.

Ongoing activities

- Preparing for training seminar for SSMC, tentatively scheduled for 28 May, to be presented to employees of Territorial Representations of SSMC.
- Participating in joint audit/IT review of Kyiv RCCA, to examine data handling practices regarding shareholders generated by results of certificate auctions, especially data submission standards of financial intermediaries.
- Developing standardized data transfer information format for shareholder data created by closed subscription sales.
- Reviewing current practices regarding shareholder information generated by the Stock Exchange.
- Working on the draft SPF Regulation on Procedure of Preferential Sale of Shares.
- Upgrading Closed Subscription Software and Manual.
- Developing a PARD members database.

Problems identified, open issues requiring decision

- Establishing the joint SPF/SSMC/PARD/PW Issuers (Registrars) Review Team to monitor the process of Registry Consolidation at the Issuer's (Registrar's) level.
- SRO status for PARD?
- Information System/Network for Registrars - SPF, UCCA, SSMC?

MAY 1997 PROGRESS REPORT

Intensive efforts were undertaken by the Price Waterhouse Mass Privatization project team during the month of May to redeploy the resources of the team to develop and introduce initiatives to advise and assist the State Property Fund to implement immediate measures to rapidly accelerate the number of enterprises prepared for certificate auctions during the June - December 1997 period.

The objective of these efforts is to ensure that the SPF and the government of Ukraine meet their target of 70% of the shares of each of 8000 medium/large enterprises sold by the end of 1997 - with a significant number of Ukraine's largest and most attractive enterprises having been largely privatized by year end.

As a result of these efforts, the following agreement was reached with the management of the State Property Fund in early June 1997:

June 10, 1997

State Property Fund of Ukraine

We are very pleased with the agreements reached and look forward to working with you to implement the initiatives summarized below.

I understand that USAID representatives will report to Washington on the outcome of our meetings and will also advise the World Bank and the IMF. Joint initiatives undertaken by the SPF with the assistance of the 80 consultants on the Price Waterhouse Mass Privatization consulting team to accelerate enterprise preparation and to increase both the quantity and quality of new enterprises offered in the PPC and CC auctions will help the SPF and the government of Ukraine to meet their privatization targets for 1997. At the same time, the positive results of these initiatives will contribute to the Ukrainian government's meeting the financing conditionalities of the World Bank and the IMF.

In summary, the following agreements were reached amongst representatives of the SPF management, USAID and the PW MPP team:

1. The SPF and the PW MPP team will agree on the text of a letter which describes the role of the latter in providing enterprise preparation assistance to the SPF, the RPF's and individual enterprises in order to accelerate the number of enterprises prepared to begin share sales for PPC's and CC's.
2. The letter will be signed by the acting Chairman of the SPF.
3. The PW MPP team will provide assistance for and participate in the two day seminar in Kyiv sponsored by the SPF during the 24-27 June period for the deputy chairmen and heads of the share sales departments of the RPF's. The purpose of the seminar will be to introduce and provide training in implementation of new orders and procedures regarding the sequence of share sales and the review of share allocation plans as well as the 1997 Program of Privatization and other new developments. During the seminar, the SPF will describe to the participants the enterprise preparation assistance role of the PW MPP team.

4. In order for the PW MPP team to carry out its methodological and practical enterprise preparation assistance to the SPF and RPF's, upon publication of the 1997 Program of Privatization recently approved by the Verkhova Rada, the SPF will provide the PW MPP team with lists of all enterprises which have completed enterprise preparation, all enterprises which are undergoing enterprise preparation and all enterprises which are to begin enterprise preparation. The lists will include share allocation plans and the status of enterprise preparation or share sales for each enterprise. The PW MPP team will utilize these lists to assist the SPF to prepare a consolidated list of enterprises (subject to change and to be updated on a regular basis) to be sold during the remaining months of 1997 in order to reach the 8000 enterprises 70% sold target by the end of this year.
5. The PW MPP team will analyze this list in order to assist the SPF to identify and resolve obstacles in the preparation and sale of the enterprises included on the list.
6. The SPF will publicize this list with the assistance of the public education project.
7. Each month, the SPF will provide the PW MPP team with the lists of enterprises (received from the RPF's) which are to participate in PPC and CC auctions during the following month and which have problems delaying their participation. Each month, the PW MPP team will provide practical assistance to the SPF, RPF's and enterprises to quickly resolve such problems in order to accelerate the participation of such enterprises in the following month's certificate auctions.
8. In terms of the quality and depth of privatization, the SPF believes that the proposal of the donors that 200 of the largest Group D enterprises (those with UAH 170 million or more in value of fixed assets) each reach 40% or more shares sold by the end of 1997 can be achieved. (The Presidential Order of 4 June will provide the SPF with the means to accelerate the adoption of share allocation plans for Group D enterprises.) The PW MPP team will assist the SPF with financial analyses of Group D enterprises.

We look forward to working with you and your colleagues to implement these initiatives which will we believe can assist the SPF in the accomplishment of its objectives for 1997.

John Johnson
Project Director

Progress Report

May 1 - May 31 1997

Key Events / Outputs

Share sales procedure

- drafted and passed to the SPF consideration concept and draft SPF order on the consequence of sales of shares; concept was discussed with some of the RPF heads;
- assisted SPF in developing standard share allocation plan in consistence with the proposed concept;
- assisted SPF in putting together amendments to the privatization initiation procedures caused by the requirements of the new privatization law;
- drafted the Procedure on Share Sale for Cash through the ACN. Participated in numeric meetings and discussions over the concept of cash auctions with the SPF and ACN officials;
- Procedure for Share Sale for Remainders on Depository Accounts was approved by the SPF on 05.15.97 and has been send for registration to the MoJ;
- Incorporated subsequent changes in the Instruction on conducting sale for leftovers on depository accounts for the ACN. The instruction is being revised by the SPF and the UCCA and will be passed for approval after the Procedures is approve
- prepared analyses on mechanisms to be utilised for sale of JSC shares for housing checks;
- prepared the analysis of the possibility of introduction of PPC tradability in the available legislative framework;
- met with SPF Stock Exchange Sales Department and discussed the existing procedures and problems of sale of shares through stock exchanges;
- prepared proposals as for the list of enterprises which can offer leftovers of shares for sale through pilot ACN regional cash auctions and recommendations for the regions, where the first pilot cash auctions could be conducted;
- prepared analysis and recommendations for the SPF's Certificate Auction Commission on the issue of share split below 1 kopeck. Auction Commission took recommendations into account. Continued the work with SEC in order to clarify this issue.

AIC Privatization Issues

- met with USAID experts to discuss issues of AIC privatization and demonopolization of "Khib Ukrainy";
- upon request from USAID, prepared a set of draft documents (COM Resolution, draft law, explanatory note) on procedure for demonopolization of "Khib Ukrainy" to be presented to Vice Prime Minister Mr.Zubets;
- met with representatives of the Ukrainian Union of Agro Industrialists and Entrepreneurs and discussed AIC privatization issues, demonopolization of "Khib Ukrainy" and possibility of co-operation in this area;
- drafted and discussed with Mr.Chernoivanov, the SPF's AIC Privatization Department Director, the joint SPF/PW work plan for development of legal documents, data analysis etc. on AIC privatization.

Investment Newsletter

- drafted the Newsletter concept paper;
- conducted a meeting with PW regional managers regarding the Newsletter concept and their role in building relations with RPF officials to arrange enterprise information gathering;

- drafted and sent via regional managers letters for the heads of RPF to get their support of the Newsletter;
- developed a standard form to fill out information on enterprises;
- agreed with the IFC possibility to cooperate in issuing joint investment Newsletter in the format used by the IFC presently;
- had a meeting with Deputy Head of Zaporizhia RPF to discuss the Newsletter concept and get his support in the enterprise data gathering in Zaporizhia oblast;
- contacted Odessa and Kyiv oblasts RPF officials regarding the Newsletter;
- started developing web-page forms to enter enterprises info.

Case Studies

- conducted interviews with financial intermediates, UCPP, UCPI, SPF and enterprises to identify the most important issues to be included in the case study;
- reviewed available case studies to identify information required for putting case study together;
- agreed with the USAID concept and strategy of the case study to be preceded by the series of training seminars for enterprise directors with the emphasis on the privatization and post privatization issues.

Other Issues

- Upon request from the USAID, drafted a comparison analysis of two draft 1997 Privatization Programs - Presidential/SPF's and Verkhova Rada's.
- Prepared analysis of the Ugarov's proposed amendment to the Compensation Law ("subtractive" compensation scheme).
- Participated in the meetings with SPF EBF Department on the issue of refunding of certificates from NBU to EBF account provided recommendations.
- Obtained an official Letter of Recommendation from Ukrainian Security Exchange Commission for the Manual on Share Issue Registration and Re-registration, drafted by PW.
- Met with Mr.Pynzenyk. Discussed the possibilities to speed up privatization in AIC and industrial sectors and possible co-operation.

Open Issues

Parliament approval of the 1997 Privatization Program (of whatever version) is still pending.

CC distribution deadline is to be extended beyond June 30th.

Amendments to the Compensation law to revive CCs is still an issue.

Development of the schedule of sales (plan - graphic) indicating names of the company and time of sales is one of the main condition for streamlining privatization.

The agreement to conduct regular meetings of PW - the largest MPP advisor to .the SPF with the SPF chairman.

Progress Report

May 1 - May 31, 1997

Key Events

- The list of enterprises offering share packages for the 29th PPC auction was published by the SPF.
- The 15th auction for CC was launched by the SPF.
- The Auction Commission approved the results of the 27th PPC auctions. 316 share packages were offered. Auction results approved for the 314 share packages. Two packages were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 1,121,955 which is the highest number since 20th PPC auction (09.1996) and one of the best result to date. Donetsk oblast's enterprises accumulated 82.34% of all PPCs invested. 5.37% of capital of "Mariupol's metallurgical plant named after Illich" were sold for 495,619 PPCs (or 44.17% of all PPCs accumulated). Auction price of these shares 5.96 times exeded the nominal value. 4.10% of capital of "Metalurgical plant "Azovstal" were sold for 422,403 PPCs (or 37.65% of all PPCs accumulated). Auction price of these shares 7.32 times exeded the nominal value.
- The Auction Commission approved the results of the 12th (03.1997) CC auction. 128 share packages were offered. Auction results approved for the 126 share packages. Two packages were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 414,652 which is 28% higher than that the previous 11th.

Key Outputs

- Assisted SPF to compile and verify the information packages for the 29th PPC auction (06.1997). A total of 354 (105 more than in the previous auction) share packages have been prepared, including 151 (25 more than in the previous auction) share packages of new enterprises. The average size of offered packages is 20.16% of the statutory fund.
- Assisted SPF to compile and verify the information packages for the 15th CC auction (06.1997). A total of 255 (82 more than in the previous auction) share packages have been prepared, including 173 (35 more than in the previous auction) share packages of enterprises that never participated in CC auctions before. The average size of offered packages is 12.66% of the statutory fund.
- Continue to compile an electronic form of unofficial list of the monopolistic enterprises based on data collected to date from different sources of information.
- Collecting in electronic format information about enterprises' SAPs published to date in "Investment Gazette", EE daily, IntelNews, etc.
- Compared SAP's information received from mass media and other available means. Conducted preliminary analysis of reliability of the SAPs' information sources.
- Prepared analytical notes on offered share packages for PPC A29 and CC A15.
- Identified and reported to the SPF the discrepancies in the UCCA and SPF's ETAP data on statutory funds and group of the enterprises for some enterprises undergoing privatization.
- Identified and reported to the SPF the discrepancies in the SPF's information about total percentage of capital sold and capital sold only via PPC and CC auctions for some enterprises undergoing privatization.
- Prepared analysis on AIC enterprises status of privatization for the SPF's AIC reformation department.

- Prepared analysis on all (AIC and non-AIC) enterprises status of privatization for the SPF's Property Reform Department.
- Prepared and presented to USAID analysis on privatization status of AIC enterprises based on SPF's and PPC and CC auctions results data.
- Prepared and presented to USAID analysis on privatization status of all group B, C, D enterprises based on SPF's ETAP data and PPC, CC auctions results data.
- Prepared and compiled preliminary list of group D enterprises. Estimated total number of group D enterprises which are subject to privatization.
- Started to work with the SPF's AIC and Property Reform Departments on compiling the list of companies to be privatized by RPFs, CA in 1997 (plan-graphics).
- Worked on the task to find new and planned for privatization but not started process enterprises. List of enterprises planned for Privatization in 1995-97 was checked. It was compared with the list of enterprises prohibited for privatization and with the available ETAP data. SPF was provided with the list of almost 3900 enterprises which are not prohibited for privatization but have no information about their privatization status.
- Updated database of enterprises to be privatize according to individual plans based on CoM decision to increase the list to 239 enterprises.
- The SPF consultants continued to provide general assistance to their assigned departments.
- Updated the auction statistics files on the office network with the results of 27th PPC auction and 12th CC auction and the list of share packages offered on 29th PPC and 15th CC auctions.
- Updated the PPC and CC distribution statistics on the office network.
- Continued to update all the available data in order to compile the Group D enterprise list.

Open Issues

- Having more information received from the SPF departments during reported period PW consultants find themselves in very sensitive position having no formal agreement between SPF, PW and USAID and been asked by SPF employees not to distribute their analysis outside SPF.
- Compiling the lists of Group D enterprises and "large" enterprises (with fixed assets value over 170 mln UAH) on the basis of available sources of information.
- Update AIC enterprises privatization stages analysis.
- Work on creating combined monthly Preparation and Sale plan-graphics.

Progress Report

May 1- May 31, 1997

Key Events

- The SPF offered its 7,798th share package for sale on 29th PPC Auction (May) and increased the total number of new enterprises which offered shares for PPC Auctions to 4,885.
- The SPF offered its 2,936th share package for sale on 14th CC Auction (May) and increased the total number of new enterprises which offered shares for CC Auctions to 2,455.
- CoM Resolution #452 “On the Order of Utilization of the Grain Produced in Ukraine” was approved on May 13, 1997, commencing the process of “Khib Ukrainy” demonopolization.
- The SPF issued the Order #555 requiring to accelerate AIC privatization to no less than 150 enterprises per month reaching 70% target as well s to establish a system of monthly reporting of the AIC privatization status.

Key Outputs

- Assisted RPFs to prepare 354 enterprise packages for the 29th PPC Auction. Of these, 151 represented enterprises which had not yet participated in PPC Auctions.
- Assisted RPFs to prepare 255 enterprise packages for the 14th CC Auction. Of these, 173 represented enterprises which had not yet participated in CC Auctions.
- Continued to provide direct technical assistance to 5 privatizing enterprises of Group D, 17 privatizing enterprises of Group C and 4 enterprises of Group B nationwide, including preparation of valuation act - 14, share allocation plan - 8, corporate charter - 5, share issue registration package - 6.
- Continued providing assistance to 24 leased enterprises of “Khib Ukrainy” in Odesa Oblast in the process of inventory.
- Commenced direct technical assistance to the 2 additional “Group D” enterprises - “Nikopol’ Thread Plant” in Dnipropetrovsk Oblast and Mykolaiv Shipyard.
- Prepared an update for USAID on privatization status of 97 leased enterprises of “Khib Ukrainy” containing description of their current status and suggestions on their privatization.
- Organized and conducted a meeting with the President of the Ukrainian League of Entrepreneurs in AIC to discuss possible of ways to accelerate AIC privatization, including privatization of “Khib Ukrainy” enterprises.
- Prepared and submitted to USAID proposals for the Vice-Prime-Minister and the Minister of Agriculture Mr.Zubets on demonopolization of “Khib Ukrainy” and acceleration of privatization of the grain-procurement enterprises.
- Conducted privatization seminars for the RPFs, local administrations and enterprise management in Zaporizhia, Lugansk, Vinnitsa, Kyiv Oblast and Kyiv City.
- Distributed 78 Property Valuation and 124 AIC Step-by-Step Guides during the reported period to privatizing enterprises nationwide.
- Finalized the draft of the Section II of the AIC Step-by-Step Manual “Privatization of the Grain-Processing Industry” and obtained comments from the RPFs.
- Continued distributing recommendations/standard documents resulting from the experience gained in the course of REPP activity to the other regions of the country through the Team’s regional staff.
- Held a meeting with former Vice Prime Minister, Mr. Pynzenyk, MP, where vital privatization issues have been discussed.

- Participated in the donors meetings and coordination meetings with IFC and Public Education Contractor.
- Members of the Team's management traveled to Zaporizha, Vinnitsya, Rivne and engaged in constructive discussions on privatization issues with RPF/enterprises management.

Open Issues

- Absence of the SPF's formal document endorsing PW direct assistance to large enterprises
- Necessity to abolish the CoM Dekret #26 to begin privatization of the grain-procurement enterprises.

 Progress Report

May 1 - May 31, 1997

Key Events

- The approval of the ACN documents regarding transformation into the closed JSC is delayed by the SPF.
- The ACN continues to operate under the performance-based financing.
- Break in the trend over the last several months whereby certificate auction activity has been declining. Significant increase in certificates invested due to the introduction of valuable enterprises into the auction process.
- Transition period in SPF Management - resignation of Grigorenko and Butsa from SPF Management.
- Political issues between the President of Ukraine and Parliament regarding Mass Privatization.
- USAID Task Order funding to be performed upon incremental basis (through June 1997 as of the end of May). Participated in Board of Directors' Meeting to outline problems in privatization companies; current status of new enterprises being offered, and plans going forward; targets set for privatization enterprises through the end of December 1997 and through June 1997.

Key OutputsACN Consulting/Certificate Auction Support

- The April evaluation of the centres related to the Financing Agreement has been completed. The prepayment was adjusted for each specific RCCA after the first round of evaluation which was held in the middle of May 1997. The total financing earned by the ACN (excluding the category of Value of Shares Sold) was 77% of the total monthly budget available. Performed review of information received from ACN regarding financing related issues.
- Met with the UCCA management to discuss the results of the allocation of the USAID financing according to the ACN performance. The positive results are:
 - UCCA demanded from the RCCAs to start restructuring of the centres in order to adjust their staffing to the levels justified by performance based financing scheme.
 - UCCA pushes the SPF to offer for the auction attractive enterprises to increase certificate collection and meet the targets established by the Financing Agreement.
- Met with the SPF representatives regarding USAID/PW assistance provided to the ACN. Presented the summary of USAID/PW financing provided to the ACN during the 1995- April 1997 and confirmed availability of the future USAID financing through 1997 in case the targets are met. Established contacts for cooperation with the SPF on the ACN financing issues.
- Continued to support and coordinate the efforts of the ACN in the sphere of Enterprise Preparation:
 - conducted joint seminar with PW-Kyiv; Kyiv RPF, the Kyiv RCCA and the UCCA regarding new legislation procedures.
 - 12 RCCAs started to work on enterprise preparation providing free technical assistance to the enterprises which are beginning the privatization process.
 - 3 regions signed the mutual RPF-RCCA-PW agreement regarding joint work on enterprise preparation.
 - compiled a list of RCCA specialists available in the regions to conduct enterprise preparation.
 - compiled the list of enterprises which may be assisted by the RCCA specialists regarding enterprise preparation.
- Visited several regions to determine cost and proper recording of USAID equipment located in RCCAs in conjunction with the joint stock restructuring. Regions are as follows: Zaporizhia,

Dniprepetrovsk, Poltava, Kirovograd, and Cherkassy. Limited procedures were performed by the joint team consisting of PW IT, Audit and ACN representatives. The visits will cover the remaining RCCAs during June 1997.

ACN Systems Support

- Continued routine maintenance, enhancement, and user support of the various production systems, including CC and PPC bid collection and auction processing systems, and the shareholders database.
- Improved the DEPO program (Financial Intermediaries certificate data) so that the UCCA can better understand the data in the DEPO reports.
- Implemented a function for removing the reservation of a financial intermediary, after they have participated in an auction. The need for this function has arisen as a result of non-payment by some financial intermediaries.
- Postponed further discussion of issues of training UCCA programmers and transfer of computer source codes. At request of UCCA, a letter has been drafted by PW to formally notify UCCA that issue has been postponed until September 1997, at which time USAID will determine the resolution of these issues.
- By UCCA request, PW drafted a letter to UCCA explaining the status of current telecommunications for the ACN, and the ACN's responsibility for future telecommunication costs.
- Installed satellite station in UCCA; continued testing with Infocom HUB station.

Monitoring ACN Activity

- Performed standard review of accounting documentation and internal controls at the following BRS locations: Zvenigorodka and Kaniv in the Cherkassy oblast; Nezin in the Chernigiv oblast; and Bila Tserkva, Barishivka and Borispol in the Kyiv oblast.
- Participated with UCCA Control Department Representatives in Exit Conference with Kyiv RCCA Management to discuss audit findings. Drafted Kyiv RCCA Audit Report of Findings. SPF individuals were invited to attend visits but were unable to perform joint audits due to time and resource constraints.
- Coordinated with the UCCA and SPF Control Departments regarding joint audits; specifically, five BRS audits and the Kharkiv RCCA (to be performed June 2nd - June 6th, 1997).
- Drafted audit program and compliance checklists for standard procedures to be performed in BRSs selected for testing during May 1997. Coordinated with the UCCA to obtain access letters as well as with the RCCA Management and PW Regional Consultants for involvement in procedures performed and related findings.
- Prepared for Kharkiv RCCA audit by coordinating with UCCA and obtaining access letter, and discussion of timing with Kharkiv RCCA.
- Prepared formal joint audit schedule for the period May 1997 - September 1997 and delivered to the UCCA for comment.
- Prepared letter of proposal to the SPF regarding joint audits, training schedule, the SPF's increased role in performing procedures within the ACN, and reporting on findings within the ACN upon performance of these procedures. Proposal has not been submitted due to the fact that the SPF Management is going through a transition period and the primary contact for such a proposal has not been identified.

Shareholders Database Support

- Through the Financing Agreement encouraged the delivery of the electronic copies of share registry information from the RCCAs to the RPFs and issuers. For the month of April, 423 of the 488 lists of shareholders were transferred in soft and hard copies by the RCCAs to either the RPFs or the issuers.

Internal Support

- Participated in discussions with EPS team regarding assisting with the Enterprise Preparation SWAT Team to work toward determining issues related to slow-paced privatization of some companies and assisting companies to resolve such obstacles efficiently and effectively.

Problems identified, open issues requiring decision

- Awaiting USAID's final decision regarding the conclusion of the MoU between the SPF and USAID on their cooperation with regard to Mass Privatization activities, which will also cover ACN financing.
- Number of new enterprises as a target for the ACN performance evaluation for the months beyond April 1997 needs to be defined by USAID in coordination with the SPF.
- Draft proposal regarding joint audits and audit training to the SPF not delivered as a counterpart leader has not been identified who will be to make the decision and facilitate action regarding the plan.
- As it was stipulated by the Final Phase Financing Agreement, USAID/PW and the UCCA will review the Agreement in June. The SPF should be involved in the process and the following issues could be discussed:
 - balance of the SPF and USAID assistance provided to the ACN.
 - ACN involvement in the Enterprise Preparation process.

Progress Report

May 1 - May 31, 1997

Key Events

- Participated in the SSMC training seminar and presented issues of the MPP shareholder information generation by the SPF and transfer to Issuers/Registrars; of the share registry software market in Ukraine and the results of the PARD's software contest conducted.
- Conducted a series of meetings with the SPF and the SSMC representatives to discuss the draft SPF Regulation on Preferential Sale of Shares.
- Attended PARD lawyers committee session to discuss new share registry regulations draft proposed by PARD.
- Started work on the joint SPF/SSMC Regulation on Procedure of the Registered Securities Owners Registry Compilation and Introduction of Changes in the result of privatization.
- Started work on elaboration of a unified shareholder register data format to be used when the registry of a certain issuer is transferred from one registrar to another (i.e., when the issuer changes its registrars).
- Participated in the USAID Capital Markets meeting to discuss the possible impact of the draft Law on the National Depository System on the development of the Shareholder Registry Industry.

Key Outputs

- To address the ACN shareholder information quality/completeness problems being transferred to Issuers/Registrars a draft SPF Order On introduction of changes to the Regulation on the procedure for submitting applications by financial intermediaries and buyers associations for purchase of shares offered for sale at certificate auctions has been developed and submitted to the SPF for review and approval. The changes concern ACN procedures of accepting and processing of the shareholder information submitted by Fis as well as the ACN software modifications to allow efficient information processing.
- Together with FMI assisted the SSMC to organize and conduct the “State Regulation and Control of the Registered Securities Registry Handling Activities” training seminar for the SSMC Territorial Representations.
- Developed a draft SPF Order on Standardization of the SPF “Order on Introduction of Changes into the Registered Securities Owners Registries” for all mechanisms of share sale and submitted it to the SPF for review and approval.
- Prepared analysis of the draft Law “On National Depository System and peculiarities of the securities electronic circulation” regarding its impact on the Shareholder Registrar Industry.
- Conducted an analysis of existing close subscription bid-entry software in order to estimate its role in automation support of the closed subscription processes as described by corresponding draft *Regulation*.
- Developed and provided to PARD recommendations regarding electronic format of registrar quarterly reports.
- Elaborated the concept, recommendations and proposals regarding share registry software certification.

Open Issues

- Obtaining approval of the SPF Regulation on the Shareholder Information Transfer from the UCCA to Issuers/Registrars.

- Developing a standardized data transfer information format for shareholder data created in the process of Preferential Sale of Shares.
- Reviewing current practices regarding shareholder information generated by the Stock Exchange.
- Working on the draft SPF Regulation on Procedure of Preferential Sale of Shares. The SPF Preferential Sale Department representatives oppose to the new proposals regarding creation of lists of share owners in a standardized format using Closed Subscription Software and approval of such lists by the SPF. The issue will be resolved after the SPF passes a final decision regarding the SPF Consolidated Share Owners Database.
- Upgrading Closed Subscription Software and Manual.
- Establishing the joint SPF/SSMC/PARD/PW Issuers (Registrars) Review Team to monitor the process of Registry Consolidation at the Issuer's (Registrar's) level.
- Developing the PARD members information system specification and design.
- Information System/Network for Registrars - SPF, UCCA, SSMC.

JUNE 1997 PROGRESS REPORT

During the month of June, the Price Waterhouse Mass Privatization project team implemented drastic measures coinciding with USAID's notification to the State Property Fund and the Government of Ukraine that, unless steps are implemented to accelerate the pace of mass privatization over the next two months, US government technical assistance to the SPF might be terminated.

USAID - and the multilateral donor institutions - have urged the SPF and the GOU to substantially increase the number of share packages of new enterprises offered each month in Privatization Property Certificate auctions and to substantially increase the number of share packages of enterprises which can reach a minimum of 70% shares sold in monthly Compensation Certificate auctions. Following the slower pace of mass privatization (versus 1996) in the first half of 1997 as a result of debilitating political turmoil and the "politization" of the privatization program, USAID and the donor institutions have strongly encouraged the SPF and the GOU to develop with donor/consultant assistance specific plans to reach the GOU's commitment to privatize 8000 medium/large enterprises (including the largest of Ukraine's industrial enterprises) by the end of 1997.

During the month of June, the PW MPP team halted all longer-term tasks and projects not directly related to the preparation of enterprise share packages for offering in the next PPC and CC auctions. All available consulting resources - more than half of the team's staff - were redeployed to the regions to assist the regional offices of the SPF in the preparation of share packages for auctioning. At the same time, intensified consulting assistance was provided to the SPF headquarters management to consult on policy, procedures and data analysis tasks necessary to process and to auction a significantly higher number of enterprises and to ensure accelerated auctions for the remainder of the year.

In response to the efforts of the SPF, the donor institutions, and their consultants to accelerate the Mass Privatization Program - despite the very difficult political environment in which we are operating, some very positive results were generated in late June/early July to re-accelerate the program and to ensure that the SPF and the GOU meet yearend privatization targets.

Following are the very positive developments for the Mass Privatization Program which have been generated over the past two weeks:

- 1) 16th (July/August) Compensation Certificate Auction: 345 enterprise share packages - which will generate more than 70% shares sold per enterprise - will be auctioned. *This represents the largest number of enterprises ever offered in one CC auction, more than two times the number of enterprises offered on average in the first six CC auctions of 1997. 221 of the share packages are from new enterprises. This represents the fifth largest number of new enterprises ever offered in a CC auction - and double the average number of new enterprises offered on average in the CC auctions of 1997. Included in the enterprises to be offered are share packages of twelve large Group D enterprises including four "giant" enterprises - including one which will offer 10% of its shares. As important, the value of shares to be auctioned = UAH 67,327,000 the largest value of share packages ever offered in a CC auction, 350% more than the average value of share packages offered in the first six auctions of 1997.*
- 2) Rada Resolution re: Extension of Certificate (PPC's and CC's) Distribution: The Parliament has passed a Resolution extending PPC and CC distribution until September 30, 1997. The

proposal to have the state invest uncollected certificates and to use future dividends from such investments to fund a state social protection fund was rejected by the Rada.

(Note: The Rada at the same time ordered Ugarov's commission to submit by September 10 a draft law on the utilization of undistributed PPC's and CC's. The draft already prepared by Ugarov calls for the sale of undistributed certificates to financial intermediaries in cash auctions- with proceeds going to the state budget. While perhaps accelerating investment by financial intermediaries in certificate auctions, this proposal would take the "mass" out of mass privatization by depriving citizens of their right to compensation in the form of certificates - and would transfer this right to financial intermediaries via the state. With the rejection by the Rada of the Socialist-sponsored social protection fund scheme today, it is unlikely that a proposal which favors financial intermediaries will be adopted by the Rada.)

- 3) Public Education Campaign for Next CC Auction: Given #2 and #3, we strongly agree with the proposal for an intensified UMREP public awareness campaign for the CC auction which begins July 16, focusing on the large number of enterprises, the large number of new enterprises, and the number of shares of very large, attractive enterprises on offer - plus the extension of CC distribution to September 30.
- 4) President Signs 1997 Privatization Program: The President this week signed the Rada's 1997 Program which, although not 100% ideal, provides an acceptable framework for acceleration of the privatization program and differs little from the President's proposal (which we participated in drafting). The 1997 Program requires that aggressive quotas be met whereby all medium and large enterprises must sell from 25% to 100% of their shares for certificates in preferential sales and public auctions (Group D enterprises must sell a minimum of 25% for certificates). All enterprises must meet these quotas *before* they can begin cash sales.
- 5) SPF Chairman to Sign the Order on the Sequence of Share Sales: With the President's signing of the 1997 Program, the acting SPF Chairman will tomorrow sign the "Order on Share Sales" which requires streamlined and standard share sales for PPC's, then for CC's, then for cash.
- 6) Second Half of 1997 Monthly Privatization Plan: In response to the request of the USAID Mission Director, the SPF is now preparing a list of a (minimum) of 2400 medium/large enterprises to be privatized (70% of shares sold) via certificate auctions and/or preferential sales (for Agro-Industrial Enterprises) during the August - December 1997 period in order to reach the 8000 enterprises sold yearend target. Lists (from among the 2400) of enterprises to be auctioned in August and September are being prepared and lists for October - December will be prepared in August and September.
- 7) SPF Response to USAID Mission Director: Please note that as of today, three of the four requests of the Director as contained in his letter of July 2 are being addressed: #1, list of enterprises to be privatized between now and the end of 1997, #2, a plan for the next two months' PPC and CC auctions and #4, a proposal to extend CC distribution. Request #3 regarding a list of large Group D enterprises to be privatized through the end of 1997 is under joint preparation with the SPF.
- 8) Reduction of Negative List: The Ministry of Economy has this week submitted a draft law to the Rada which, if approved, would cancel all Rada Resolutions regarding the definitions (generally vague and ambiguous) of categories of enterprises to be excluded from privatization. The draft would *reduce the negative list of enterprises not subject to*

privatization from roughly 5100 to 2500 and would cancel the notorious Dekret #26 which seeks to prohibit privatization of grain related storage and processing enterprises.

- 9) Ministry of Agriculture Approves Privatization of “Khib Ukrainy”/Grain Industry: We have reviewed the copy of the Ministry of Agriculture’s June 13 proposal to the Cabinet of Ministers provided to us today by the World Bank. We are very pleased to see that the proposal essentially addresses the requirements of the donors and the commitments of the GOU made in Washington in May: to demonopolize and privatize Khib Ukrainy/grain sector enterprises.

The proposal is very clear and unambiguous: *Of the 879 AIC enterprises which belong to the grain storage/processing/and related sector: 279 have already been privatized or have completed preparation for share sales. 25 are in the processing of preparation for share sales. 17 are on the negative list/not subject to privatization.*

That leaves 558 enterprises in Khib Ukrainy. Of these, the proposal calls for 423 enterprises to begin preparation for privatization immediately. 135 enterprises - including fewer than 100 grain elevators and some related/smaller/attached enterprises - are to remain under the control (full or partial state ownership) of Khib Ukrainy. It is important to note that the proposal clearly states the Law on Privatization and the Law on Agro-Industrial Privatization override Dekret #26.

This is all very good news and will likely be presented by Vice Prime Minister Zubets during his meeting with the World Bank and USAID next week. However, *one note of caution:* It is critical that - along with adoption of this privatization proposal by the Cabinet of Ministers - there be a *demonopolization and reorganization of Khib Ukrainy Decree which introduces amendments to Cab Min Resolution #1000. Why? Because without the latter, Khib Ukrainy (Min Agro) would be able to retain significant shareholdings/control over the 423 enterprises. Thus, it is important that, when Vice PM Zubets presents his proposal to the donors, the donors respond by saying “great, but please also issue a demonopolization order to coincide with the Cab Min’s privatization Resolution.”*

Progress Report

June 1 - June 30, 1997

Taking into account the decision to temporarily halt project activity related to longer term project tasks and to reallocate project resources, the present report does not cover the case studies project and related training tasks nor the Investment Newsletter project as they been temporarily terminated.

Key Events

- Verkhovnyaya Rada passed the Law on the 1997 State Privatization Program and the Law on the State Property Fund of Ukraine.
- The draft Law on Nationalization was disapproved in the first hearing by Verkhovnyaya Rada.
- The draft Law on the (significantly reduced) List of Enterprises Prohibited from Privatization was submitted to Verkhovnyaya Rada by the Cabinet of Ministers. The draft List contains 2500 enterprises.
- A series of meetings between USAID and SPF senior management to discuss the SPF action plan to overcome present crisis/slow down in privatization were conducted with the active participation of PW project management and team leaders.

Key Outputs

- The draft SPF Order on the Procedures for Share Allocation Plan revisions, ensuring streamlined procedures for share sales and a new standard share allocation plan format were agreed with the SPF departments and passed to the SPF Acting Chairman for his signature.
- The SPF Order on preparing for the 16th CC auction contained new requirements to offer shares of only those companies which if offered at the auction would be sold to 70% level and to allow for the offering of more than 30% (of statutory capital) share packages.
- The SPF Regulations on the Submission and Acceptance of the Application for Privatization and on the Privatization Committee, required by the new provisions of the 1997 Law on Privatization, were signed by the SPF Acting Chairman.
- The agenda for the seminar for RPF deputy heads and share sales department directors on the new privatization regulations and procedures was agreed with the senior SPF management, document packages prepared for distribution and PW team member presentations prepared.
- The major joint PW/SPF work plan for the development of legal, methodological and analytical documents for agro-industrial privatization acceleration was successfully completed.
- The draft amendment to the Cabinet of Ministers' Resolution #218 on the Procedures for conducting certificate auctions related to the decision of the Securities Commission to impose minimum nominal value of shares equal to 1 Kopeck was submitted to the SPF for consideration.
- 3 different drafts of a letter from the PW team to the SPF management to officially authorize PW Enterprise Preparation team to assist the SPF in preparing/verifying enterprises for the PPC and CC auctions were prepared and submitted to the SPF.

Open Issues

- "Plan Graphic" list of companies to be privatized month-by-month through the end of 1997 with 70% depth of sales to be compiled.
- SPF to develop action plan to streamline privatization per orders from the Acting Chairman of the SPF and the GOU..

- Verkhovynaya Rada to decide to extend CC distribution until March 31, 1998.
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) to be passed (particularly after Verkhovynaya Rada approval of the State Budget for the Year 1997).
- The draft PW authorization letter, if signed by the appropriate SPF authority, will help to increase effectiveness of our enterprise preparation work.
- The draft PW technical assistance plan for the second half of 1997, awaiting the signatures of SPF management, would more clearly define monthly joint work plans to assist the SPF/GOU in accomplishing their 1997 privatization targets.

PROJECT TEAM:
COMPONENT:

PRIVATIZATION STRATEGY ADVISORY TEAM
PRIVATIZATION DATA ANALYSIS TEAM

Progress Report
June 1 - June 30, 1997

Key Events

- The list of enterprises offering share packages for the 30th PPC auction was published by the SPF. 371 share packages being offered for sale. The highest number for 1997.
- The 16th auction for CC was launched by the SPF. 345 share packages being offered for sale. The highest number of packages ever offered for CC auctions.
- The Auction Commission approved the results of the 28th PPC auctions. 248 share packages were offered. Auction results approved for the 246 share packages. Two packages were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 826,211 which is the second best number since 21th PPC auction (10/96) and better than average number for 1995-97 auctions. Dnipropetrovsk oblast's enterprises accumulated 52.1% of all PPCs invested. 12.98% of capital of "Southern Group of Mines" was sold for 299,671 PPCs (or 41.9% of all PPCs invested). Auction price of these shares exceeded by 4.75 time the nominal value. 8% of capital of "OJSC Rosava" was sold for 166,608 PPCs (or 23.3% of all PPCs accumulated). Auction price of these shares exceeded by 15 time the nominal value.
- The Auction Commission approved the results of the 13th (04/97) CC auction. 117 share packages were offered. Auction results approved for the 116 share packages. One package was withdrawn by SPF from the auction because of mistake found after publication.
- The number of winning certificates was 461,289 which is 10% higher than that the previous 12th CC auction. 14.6% of capital of "OJSC Volin" from Rivne oblast was sold for 148,534 CCs (or 32.2% of all CCs invested). Auction price of these shares exceeded the nominal value by 7.3 times.

Key Outputs

Regular work \ reports.

- Assisted SPF to compile and verify the information packages for the 30th PPC auction (07/97). A total of 371 (17 more than in the previous auction) share packages have been prepared, including 170 (19 more than in the previous auction) share packages of new enterprises. The average size of offered packages is 23.18% of the statutory fund.
- Assisted SPF to compile and verify the information packages for the 16th CC auction (07/97). A total of 245 (90 more than in the previous auction) share packages have been prepared, including 221 (48 more than in the previous auction) share packages of enterprises that never participated in CC auctions before. The average size of offered packages is 15.22% of the statutory fund.
- Prepared analytical notes on offered share packages for 30th PPC and 16th CC auctions.
- Started to work with SPF's press department to provide them with the standard PW PPC and CC auctions analytical notes.
- Identified and reported to the SPF the discrepancies in the SPF's information about total percentage of capital sold and capital sold only via PPC and CC auctions for some enterprises undergoing privatisation.
- Prepared analysis on privatisation status of enterprises to be privatized according to individual plans ("CoM's list").
- Updated the auction statistics files on the office network with the results of 28th PPC auction and 13th CC auction and the list of share packages offered on 30th PPC and 16th CC auctions.
- Updated the PPC and CC distribution statistics on the office network.

- Started to work on creating additional standard reports on “Group D” and “Group D-large only” for enterprises which participated in PPC and CC auctions.

Special Tasks completed at request of client, MPP team and other parties:

- Supplied PW’s Enterprise Preparation (EP) team, SPF, IFC with the list of 1,500 enterprises which did not reach 70% sold and should be checked by RPFs for possibility to offer shares for the 16th CC auction. As a result, 90% of packages being offered for 16th CC auction are from this list.
- Conducted “on-line” analysis of share packages to be offered in 16th CC auction in order to report and possibly improve the quality of the forthcoming auction.
- Created electronic format and verified list of 185 enterprises which could be considered as reserve of 1997 privatisation program. Provided EP team and SPF with conclusions and recommendations.
- Working with the EP team, collected in electronic format information about enterprises stopped in different privatisation stages. Provided EP team with the verified lists.
- Prepared information about grain industry (“Khleb-Ukrainy” and non-“Khleb-Ukrainy” enterprises) privatisation status for EP team.
- Updated analysis on AIC enterprises status of privatisation for the SPF’s AIC department.
- Updated analysis on privatisation status of AIC enterprises based on SPF’s and PPC and CC auctions results data.
- Started to collect RPFs’ reports about AIC preferential sales status.

Data collection \ verification.

- Started to work on creating combined monthly Auctions and Sale plan-graphics.
- Continued to update in electronic format information about enterprises’ SAPs published to date in “Investment Gazette”, EE daily, Intelnews, etc.
- Continued to compile and verify list of group D enterprises.
- Continued work with the SPF’s AIC and Property Reform Departments on compiling the list of companies to be privatised by RPFs and Central Office in 1997 (plan-graphics).
- Updated information about privatisation status of the Cabinet of Ministers’ list of enterprises.
- PW SPF consultants continued to provide general assistance to their assigned departments.
- Continued to update all the available data in order to compile the Group D enterprise list.
- Started to compile and verify unofficial list of the “strategic” enterprises based on data collected from CoM.
- Started to compile and verify new unofficial list (reduced to 2500 enterprises) of the “prohibited” enterprises based on data collected from CoM.

Open Issues

- Work with SPF on reclassification of groups of enterprises undergoing privatisation.
- Work with SPF on obtaining, verifying information about fix assets of enterprises from Ministry of Statistics in order to compile the list of “large” enterprises (with fixed asset values over 170 mln UAH each).
- Prepare Central Office (CA) enterprises privatisation stages analysis.
- Create the list of CA enterprises to be transferred from the SPF (CA) to the RPF’s for sale.
- With access to data, would work with SPF on preparing the list of 2500 enterprises which should be sold by the end of 1997.
- Absence of the lists of privatised to date enterprises makes it very difficult to predict results and to see the progress, define the goals and targets of the MP program.

- Absence of the “authorization letter” is still an issue. It causes unpredictable problems in analysis preparations and formally allows SPF not to share any data with PW.

Progress Report

June 1- June 30, 1997

Key Events

- The SPF offered its 8,163rd share package for sale on 30th PPC Auction (June) and crossed the benchmark of 5,000 new enterprises offered for sale at PPC Auctions (the total number of new enterprises which offered shares for PPC Auctions is 5,055).
- The SPF offered its 3,281st share package for sale on 16th CC Auction (June) and crossed the benchmark of 2,500 new enterprises offered for sale at CC Auctions (the total number of new enterprises which offered shares for CC Auctions is 2,676).
- The SPF required that all the enterprises put up for the 16th CC Auction must reach 70% level of sale after the Auction. Additionally, the limitation of not more than 30% of statutory capital put up for CC Auction was not applied.
- Ministry of Agriculture and the State JSC “Khib Ukrainy” issued the joint Order of June 04, 1997, #28/10-25-2/101 On Privatization of the Grain Marketing and Distribution Facilities approving a plan for privatization of 423 grain enterprises in 1997. The plan was submitted by the Ministry of Agriculture to the CoM along with the letter confirming that CoM Dekret #26 was overridden by the Law On Privatization of the State Property.
- Ministry of Justice sent to the SPF a letter of June 26, 1997, #65-69-323 confirming that the Dekret #26 was overridden by the Law On Privatization of the State Property and, thus, grain marketing and distribution facilities - except for the structural subdivisions keeping the national emergency grain reserve - are subject to privatization.
- The SPF acting Chairmen Lanovyi signed a first EP document - the valuation act - prepared with assistance of (= prepared by) PW consultants for a Central Office group D enterprise - "Tsentrolit" (Odesa).
- Due to the urgent need to accelerate enterprise preparation in advance of the 30th PPC and 16th CC Auctions, a temporary multidisciplinary Task Force was formed to analyze the privatization pipeline, identify the major causes for delay in privatization process, and liaise with GoU officials to facilitate accelerated privatization process. The Enterprise Preparation Acceleration Task Force (EPATF) comprises a core team of seven consultants with expertise in valuation, shareholder registration, and privatization legislation. Several of the consultants were pulled from longer term activities envisioned under the Task Order (i.e. Privatization Newsletter, Case Studies). These longer term activities have been temporarily postponed to enable PW MPP to focus on immediate goal of accelerating enterprise preparation during June and July, 1997.

Key Outputs

- Assisted RPF's to prepare 371 enterprise packages for the 30th PPC Auction. Of these, 170 represented enterprises which had not yet participated in PPC Auctions.
- Assisted RPFs to prepare 345 enterprise packages for the 16th CC Auction. Of these, 221 represented enterprises which had not yet participated in CC Auctions.
- In the framework of the EPATF coordinated the assistance of Kyiv-based MPP staff from other project teams provided to the RPF's in preparing information packages for the 16th CC Auction. A training seminar on information packages preparation was conducted for 12 project staff who then traveled to the RPF's and prepared information packages.
- Facilitated prompt delivery of information relevant to the 16th CC Auction (e. g. results of 28th PPC Auction) thus contributing to the overall success of the 16th CC Auction.
- Coordinated involvement of ACN staff in the regions in preparation of 16th CC Auction.

- On request of the SPF conducted regional verification of the list of 235 enterprises delayed in the process of preparation for privatization. The results of verification have been consolidated by PDAT and presented to the SPF.
- Although with reduced scope, continued to provide direct technical assistance to 5 privatizing enterprises of Group D and 12 large privatizing enterprises of Group C nationwide.
- Started direct technical assistance to 5 additional Group D enterprises: Torez Electric Plant (Donetsk), Slavyansk Ceramic Plant (Donetsk), Prosyana Mine (Dnipropetrovsk), Kryvyi Rig Cement Plant (Zaporizhya).
- In the framework of EPATF, conducted series of meetings with SPF, SSC, CoM officials to discuss delays in the pipeline and ways of acceleration of enterprise participation in PPC and CC Auctions.
- By request of USAID, drafted a proposal on the “Khib Ukrainy” demonopolization and privatization for the Vice-Prime-Minister Zubets.
- Prepared an analysis of the privatization status/progress of grain industry enterprises.
- Visited “Khib Ukrainy” representative office for Mykolaiv Oblast to discuss opportunities for privatization of “Khib Ukrainy” enterprises.
- Visited 2 elevators, 2 grain marketing and distribution facilities in Mykolaiv, Odesa and Kherson Oblasts to deliver a message regarding beginning privatization of the "Khib Ukrainy" enterprises as well as to explain advantages of privatization to the “Khib Ukrainy” enterprises currently subordinated to the Ministry of Agriculture and to encourage the initiation of privatization..
- Drafted a proposal on the procedure for privatization of grain industry enterprises, which structural subdivisions keep national emergency reserves, and submitted it to the SPF for consideration.
- Finalized Part II (“Privatization of Grain Enterprises”) of the “Step-by-Step” Manual for AIC Enterprises.

Open Issues

- Absence of month-by-month, enterprise-by-enterprise privatization schedule agreed to by the SPF and the donors in order to meet the Mass Privatization targets.
- Procrastination in enacting the Privatization Program for 1997.
- Uncertainty surrounding the SPF official document endorsing PW enterprise preparation assistance.

PROJECT TEAM: AUCTION CENTER NETWORK

Progress Report

June 1 - June 30, 1997

Key Events

- Participated in meeting with the following Representatives from the National Bank of Ukraine (NBU), Sperbank (SBU) and the State Property Fund (SPF) Lyudmila Arkadjjevna Bazarjya, Galina Danilovna Pahadchuk, Larisa Stanislavovna Komarova, Victor Fedorovich Zinenlo in the PW office to discuss current regulations and procedures for the “End of PPC Distribution Period”. Discussion followed with PW members as well as among PW counterparts as to how to proceed procedurally with post PPC distribution. Obtained statement from Sperbank that PW may perform procedures within Sperbank but that Sperbank personnel will not be participating in the procedures. Also, did not obtain confirmation that SPF or NBU personnel would perform joint procedures with PW.
- SPF approved procedures for the ACN to process share sales for remainders in privatization accounts.
- Reorganized and restructured audit team temporarily to perform Enterprise Preparation work within the scope of the PW Acceleration of Mass Privatization efforts; team members were debriefed on current issues and general information regarding preparation of enterprises for sale and performed related work in the regions.

Key Outputs

ACN Consulting/Certificate Auction Support

- Met with UCCA management to discuss the recent enterprise pool for auctions, and resulting auction results, and to work out the plan of joint efforts between PW and the UCCA to overcome the stagnation period and push the RPFs and the SPF to offer more and better enterprises for auctions.
- Because of the current crisis situation, provided additional resources from the RCCAs to the RPFs under a new Memorandum of Understanding regarding EP assistance between the UCCA and PW. Initiated and drafted the UCCA Order which demands the RCCAs to utilize RCCA employees to prepare packages for the 16th CC Auction. Coordinated the regional RCCA employees’ work and supplied representatives with necessary documents to perform EPS related work.
- Participated in the preparation of share packages for the 16th CC Auction in the Lviv region within the “Crisis Action Plan” reallocation of PW resources.
- Provided regions with the latest information on the results of the 13th CC Auction and the 28th PPC Auction so that RPFs could revise Share Allocation Plans (SAP) and prepare more packages for the upcoming auctions.
- On June 17, prepared and conducted seminar for RCCA Directors regarding current Financing Agreement between PW and the ACN. During the seminar the following issues were highlighted:
 - new developments in UMPP policy;
 - performance-based financing;

All materials related to the new developments in the sphere of enterprise preparation were prepared in soft copies and distributed to the RCCA directors during the seminar.

- Worked out new scheme of USAID financing distribution which is more balanced amongst five performance criteria. Made changes to the Financing Agreement which were signed by the UCCA on June 17th.
- Completed May ACN financing evaluation according to the new financing distribution scheme. According to the evaluation, the ACN earned \$138,023 in May 1997. The category “Number of

Enterprises which reached 70% sold” will be accounted for after the results of the respective auctions are approved by the SPF.

- After having obtained results of April auctions, calculated the budget versus actual for the category “Value of Shares Sold” for April, 1997 for the ACN. The total value was 106% of the budgeted amount; total financing distributed related to this category amounted to \$39,892. The entire sum of financing, earned by the ACN in April is \$230,190.
- Continued to support and coordinate the efforts of the ACN in the sphere of EP.

ACN Systems Support

- Routine maintenance, amendment, and user guidance have been undertaken for the various live systems including CC and PPC bid collection and auction processing systems.
- Developed new version of Financial Intermediaries Data Entry software package with ability to create list of people who have remainders in privatization accounts.
- By UCCA request implemented minor changes in auction system reports.
- Two satellite stations were completely installed and tested (Kyiv - UCCA and Odessa RCCA).
- New version of the regional Telecommunications Utility Node 4.20 (able to send data via satellite system) was prepared and sent to the regions.
- Prepared the final version of Ukrainian and English software project inventory documents "Computer information systems developed in the course of Mass Privatization Project in Ukraine as of 31 May 1997" and " List of Manuals for users of the software developed in the course of Mass Privatization Project In Ukraine".
- Continued work on software package for conducting of share sales for remainders in privatization accounts.

Monitoring ACN Activity

- Performed standard review of accounting documentation and internal controls at the Kharkiv RCCA (June 2 - June 6).
- Participated with UCCA Control Department Representatives in Exit Conference with Kharkiv RCCA Management to discuss audit findings. Drafted Kharkiv RCCA Audit Report of Findings. SPF individuals were invited to attend the visit but were unable to perform joint audits due to time and resource constraints.
- Prepared and documented workpapers for the Kharkiv RCCA visit.
- Prepared and documented workpapers as well as drafted Report of Findings resulting from audit work performed in the following BRS locations: Zvenigorodka and Kaniv in the Cherkassy oblast; Nezin in the Chernigiv oblast; and Bila Tserkva, Barishivka and Borispol in the Kyiv oblast.
- Held internal meetings with Policy Department, and reviewed current regulations regarding End of PPC distribution procedures. Performed analysis of where the most significant number of non-distributed certificates are located by region and drafted audit program and compliance checklists for standard procedures to be performed in those regions harboring the largest percentage of non-distributed PPCs during the End of PPC Distribution period tentatively in July of 1997.
- Prepared for Odessa and Sevastopol RCCA visits by coordinating with UCCA, obtaining access letters, and discussing the timing of the trips with the related RCCAs (to be performed July 7 - July 11). Coordinated with the UCCA and SPF Control Departments regarding joint audits at the Sevastopol and Odessa RCCAs.
- Prepared for distribution and distributed Audit Report of Findings for the Zakarpatskiy, Lviv, and Kmelnivsiy performed during the first quarter of 1997 to USAID, UCCA and SPF representatives.
- Began drafting a training program for representatives of the SPF which will at a minimum be given to the SPF for internal use or presented to the SPF during a seminar, given the SPF Chairman’s authorization.

Internal Support

- Participated in discussions with EP team regarding the possibility of the audit team assisting with the Enterprise Preparation SWAT Team and utilizing audit team members to increase the rate of privatization by consulting with RPFs in different regions.
- Participated in training seminar conducted by the EP Team regarding enterprise share packages and the process of privatizing enterprises in preparation for audit team's expanding role within EPS during this "UMPP Acceleration Period".
- Three audit team members traveled to four different regions (Vinnitsa, Kmelnivtsiy, Zakarpatskiy, and Ivano-Frankivsk) to assist RPFs in preparing enterprises for sale and in consulting regarding questions of those enterprises which remain "in the pipeline". Drafted report of activities for review by EPS Department.

Problems identified, open issues requiring decision

- Prepared proposal letter to the SPF regarding joint audits, training schedule, the SPF's increased role in performing procedures within the ACN, and reporting on findings within the ACN upon performance of these procedures in May 1997. Proposal has not been submitted due to the fact that the SPF Management is going through a transition period and the primary contact for such a proposal has not been identified.
- Disk storage capacity should be increased for Shareholders Database maintained in the UCCA.
- Subcontractor "Infocom" ordered additional equipment for satellite network; network start-up date expected in second half of July.
- Four Regional Centers are moving to a different location and should move the related satellite stations.
- SPF-PW-UCCA MOU should be discussed and signed.
- The following issues await further clarification at the SPF (as was stipulated by the Final Phase Financing Agreement, USAID/PW and the UCCA should review the Agreement in June):
 - 1-balance of the SPF and USAID financial assistance provided to the ACN.
 - 2-ACN involvement in the EP process.

PROJECT TEAM: MPP SHAREHOLDER REGISTRATION PROJECT TEAM
("MPP/SRP TEAM")

Progress Report

June 1 - June 30, 1997

Following the recent MPP "crises" and the PW MPP Board of Directors decision to halt all longer term non EP related tasks and to focus on the priority enterprise preparation tasks in order to streamline privatization and increase the number of enterprises beginning share sales through Certificate Auctions, the SRP Team members were assigned additional specific EP tasks while continuing to follow up with counterparts only on the most important of the SRP tasks.

Key Events

- Conducted a series of meetings with the SSMC representatives Messrs. Boiko, Romashko and Ulianov to agree on the SSMC's possible assistance in solving the Share Issue Registration problems, i.e. sabotage by the enterprise management, lack of financial resources to pay the State Duty, delays by the SSMC/TR SSMC.
- Met with the PW MPP Regional Consultants to discuss enterprise preparation problems and identify the problems which can be addressed immediately.
- Conducted a series of meetings with Messrs. Chernoiwanov and Bayura (SPF) to study the AIC JSCs problems with maintaining their shareholder registries.

Key Outputs

- Drafted and delivered to the SSMC a letter to enterprises which sabotage Share Issue Registration threatening them with financial fines, a letter to the SSMC regarding improving the Share Issue Registration Process together with a list of enterprises having problems with Securities Issue Registration.
- Drafted and delivered to the SPF a letter to the SSMC regarding enterprise problems with the Share Issue Registration and the list of enterprises having problems with the Securities Issue Registration.
- Provided to the SPF a draft Law "On Introduction of Changes to the COM Decree #... on State Duty" abolishing the Share Issue Registration State Duty for the state enterprises to be privatized.
- Drafted and provided to the SPF the joint SPF/SSMC Regulation on Procedure of the Registered Securities Owners Registry Compilation and Introduction of Changes After Each Stage of Privatization for review and comments.
- Prepared and provided to the SPF an analysis of the AIC JCSs shareholder registry maintenance problems and "peculiarities" and proposed solutions to the problems.
- Debriefed Mr. Gordienko (PARD) on the problems of the AIC JSCs with maintaining their shareholder registries and solutions proposed by the SPF and suggested to him to provide to the SPF PARD's vision of the solutions to the mentioned problems.
- Assisted PARD in estimating and planning hardware equipment needed to set up PARD's office.
- Continued work on elaboration of a unified shareholder registry data format to be used when the registry of a certain issuer is transferred from one registrar to another.

Open Issues

- SSMC's active role in streamlining the Share Issue Registration for enterprises to be privatized.
- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.

- Approval of the SPF Regulation on the Shareholder Information Transfer from the UCCA to Issuers/Registrars.
- Approval of the SPF Order on introduction of changes to the regulation on the procedure for submitting applications by financial intermediaries and buyers associations for purchase of shares offered for sale at certificate auctions.
- Approval of the SPF Regulation on Procedure of Preferential Sale of Shares.
- Developing a standardized data transfer information format for shareholder data created in the process of Preferential Sale of Shares.
- Upgrading Closed Subscription Software and Manual.
- Developing a final version of the system specifications (functional requirements, data model, etc.) for PARD Members Database.
- Introduction by the SSMC of the simplified electronic format for the registrar quarterly reports.
- Introduction by PARD of a unified Shareholder Registry Data format to be used for registry transfer between registrars.
- Shareholder Registry Software certification.

JULY 1997 PROGRESS REPORT

A number of significant new initiatives were introduced during July which - if effectively implemented - will permit the State Property Fund and the Government of Ukraine to complete the Mass Privatization Program and the privatization of nearly all medium and large enterprises (including the country's largest and most viable enterprises) by mid-1998.

The Chairman and management of the SPF agreed with the World Bank (and USAID and other donor agencies) to accomplish the following privatization goals in the context of the World Bank's EDAL II loan conditionalities:

GOU COMMITMENTS

Mass Privatization Program Targets

6500 medium/large enterprises 70% privatized (since Jan 1, 1995) *by Sep 30, 1997.*

8000 medium/large enterprises 70% privatized (since Jan 1, 1995) *by Dec 31, 1997.*

9500 medium/large enterprises 70% privatized (since Jan 1, 1995) *by Mar-June 1998.*

Large Enterprise Privatization Targets

40% of all "largest" (>UAH 170 mil fixed assets) enterprises approved for privatization reach at least 40% depth of privatization *by Sep 30, 1997.*

60% of all "largest" (>UAH 170 mil fixed assets) enterprises approved for privatization reach at least 40% depth of privatization *by Dec 31, 1997.*

80% of all "largest" (>UAH 170 mil fixed assets) enterprises approved for privatization reach at least 40% depth of privatization *by Mar - June 1998.*

Reduction of State Shareholdings Targets

At least 3250 medium/large enterprises 100% privatized (since Jan 1, 1995) *by Sep 30, 1997.*

At least 4000 medium/large enterprises 100% privatized (since Jan 1, 1995) *by Dec 31, 1997.*

At least 4750 medium/large enterprises 100% privatized (since Jan 1, 1995) *by Mar-June 1998.*

Grain Processing Industry/"Khib Ukrainy" Privatization Targets

"Demonopolize" Khib Ukrainy *by Sep 30, 1997.*

Initiate privatization of 100 grain processing enterprises *by Sep 30, 1997.*

50 such enterprises begin share sales *by Sep 30, 1997.*

20 such enterprises 70%+ sold *by Sep 30, 1997.*

150 such enterprises begin share sales *by Dec 31, 1997.*

40 such enterprises 70%+ sold *by Dec 31, 1997.*

400 such enterprises begin share sales *by Mar - June 1998.*

80 such enterprises 70% sold *by Mar - June 1998.*

MPP PROGRESS TO DATE

In terms of progress toward meeting these objectives, the following are indicative MPP benchmarks as of July 31, 1997:

Certificate Distribution

- 44.6 million citizens (89% of the current population) have collected their PPC's

- 19% of the total value of CC's available for distribution have been collected by the public (representing UAH 577 million nominal value and 32.6 million CC's)

Certificate Auctions

- 5212 enterprises have participated in PPC auctions
- 3053 enterprises have participated in CC auctions

Enterprises Privatized

- 5510 medium/large (Groups B, C, D) enterprises have been privatized (i.e. sold 70%+ shares, including 4197 enterprises which have sold 100% of their shares) since Jan 1, 1995. *Note: These numbers do not include the several hundred agro-industrial enterprises which, although relatively small, have sold shares via the agro-industrial privatization scheme in PPC and CC auctions. All small enterprises - although they may have participated in PPC and CC auctions - are not included by the SPF in their medium/large enterprise privatization statistics as reported to the World Bank.*
- 6744 medium/large (Groups B, C, D) enterprises have been privatized (sold 70%+) since Jan 1, 1992.

Largest Enterprises

- 279 large enterprises (out of 366 in the privatization "pipeline") are currently conducting share sales, including 47 enterprises classified as "giant" enterprises (i.e. the very largest of Ukraine's industrial enterprises in terms of fixed asset values)
- Of these, 107 have sold 70%+ of their shares, including 13 giants.
- 235 enterprises have participated in PPC/CC auctions, including 42 giants.

Privatization "Pipeline"

Currently, the following numbers of enterprises are at various stages in the privatization "pipeline" (i.e. have yet to reach 70%+ shares sold):

- 2005 Group B, C, D enterprises have begun share sales but have sold < 70% of their shares
- 323 Group B, C, D enterprises have completed the preparation process and are ready to begin share sales
- 645 Group B, C, D enterprises are in various stages of preparation for share sales

JOINT WORK PLANS TO REACH PRIVATIZATION GOALS

Based upon the above data, the State Property Fund/Government of Ukraine - with effective planning for future PPC and CC auctions (and other forms of share sales) - can easily meet its privatization objectives as agreed with the World Bank and USAID for 1997/98. Critical to accomplishing the Mass Privatization Program Targets as listed above is longer term planning (e.g. planning for the next seven or eight months versus last minute, month-by-month planning) for enterprise preparation and share sales targets for those enterprises in the privatization "pipeline".

A major accomplishment during the month was thus the agreement between the management of the SPF and the PW/MPP team on two very specific work plans: the "Joint SPF/PW/IFC Work Plan for Acceleration of the MPP" and the "Joint SPF/PW Work Plan for Acceleration of Agro-Industrial Sector Privatization".

The USAID/PW MPP team had proposed to the management of the SPF that the regional consulting, enterprise preparation, share sales planning, data analysis and strategy/policy/procedures resources of the team be more effectively utilized by the SPF and the Regional SPF branches to develop realistic monthly auction plans which match the privatization "pipeline" in each oblast.

The major points of the PW MPP team's proposals to the management of the SPF as incorporated in the Work Plans are:

- Discontinue orders to each Regional SPF office to generate a specific number of share packages - month-by-month - for each PPC and each CC auction.
- Discontinue the emphasis on numbers of share packages (400) to be generated for each auction.
- Discontinue the practice of share package "splitting" (i.e. dividing a large share package allocated for PPC auction or CC auction into smaller packages offered in multiple auctions).
- Discontinue the practice of "re-auctioning" old share packages in PPC auctions (i.e. do not offer in PPC auctions share packages of enterprises which have already participated in PPC auctions or share packages which were not sold in previous PPC auctions).

Instead, the team's proposals to the SPF management include the following new PPC and CC auction guidelines:

- Transfer all Group B and C enterprises from the SPF Central Office to the Regional SPF branches for preparation and share sales.
- Offer only share packages of new enterprises (i.e. first time participants) in PPC auctions.
- Offer 150 to 200 new enterprise share packages in each monthly PPC auction, no "old" packages.
- All share packages of "old" enterprises (those which have already participated in one PPC auction) should be offered in the next CC auction.
- All shares unsold in PPC auctions and all shares allocated for CC auctions should be offered - at one time - in the next CC auction.
- Offer 400 share packages in each monthly CC auction of those enterprises which - following the auction - will reach either > 70% shares sold or 100% shares sold.

To assist in the implementation of these new auction guidelines, the team's proposals to the SPF management regarding monthly PPC and CC auction planning have been incorporated in the Work Plans:

1. SPF develop a universal list of all enterprises including the largest Group D enterprises - by region - which might offer share packages in PPC and CC auctions during the remaining months of 1997 and the first quarter of 1998.
2. PW MPP consultants assist the Regional SPF branches - and the SPF headquarters (which oversees the privatization of all Group D/largest enterprises) - to determine whether the SPF's list conforms with the data and status of each enterprise in each region and to prepare month-by-month PPC and CC auction plans for the next several months - based on the universe of enterprises in the region and the PPC/CC auction guidelines indicated above.
3. SPF utilize regional input to prepare final month-by-month (through yearend 1997 and first quarter 1998) PPC and CC auction schedules for each region.
4. PW MPP consultants assist the Regional SPF branches and the SPF headquarters to prepare enterprise share packages for forthcoming PPC and CC auctions according to the plans agreed between the Regional SPF branches and the SPF. Focus to be on preparation of Group D/largest enterprise share packages.

In sum, July was a very productive month in terms of commitments to achieve goals, progress toward meeting such goals, and new initiatives implemented to meet the final mass privatization targets of the State Property Fund and the Government of Ukraine.

Attached, please find more detailed updates on the progress of the MPP team's strategy/policy, data analysis, enterprise preparation, regional consulting, auction center network consulting (including UCCA and IT consulting and audit) and MPP shareholder registration tasks .

Progress Report

July 1 - July 31, 1997

Taking into account the decision to temporarily halt project activity related to longer term project tasks and to reallocate project resources, the present report does not cover the case studies project and related training tasks nor the Investment Newsletter project as they have been temporarily halted.

Key Events / Outputs

- The President of Ukraine vetoed the draft Law on SPF, main reason being subordination of SPF to the Rada;
- Verkhovnaya Rada discussed but failed to pass the Law on transfer of undistributed certificates to the Social Security Fund;
- Verkhovnaya Rada discussed the Law on changes to the Law on Enterprises, which introduce a new category of state-owned (“kazennyje”) enterprises. PW prepared an analysis of this draft.
- The joint PW/SPF August/September work plan for the development of legal, methodological and analytical documents, assistance in enterprise preparation, enterprise data processing etc. was drafted and discussed with SPF.
- The draft SPF Order on the Procedures for Share Allocation Plan revisions, ensuring streamlined procedures for share sales and a new standard share allocation plan format was approved. A detailed Instruction Letter on the issue was also drafted and approved.
- SPF (with active PW assistance) conducted a seminar for RPF deputy heads and heads of share sale departments. Its’ purpose was to provide update and instructions on: reviewing share allocation plans according to the 1997 Privatization Program, new sequence of share sales and new quotas for certificates; new SPF orders and regulations on AIC privatization and other issues. PW made 5 presentations at the seminar and assisted in drafting the agenda, preparing and distributing the set of hand-outs (more than 40 documents, including PW drafts), organizational issues, financing etc.
- The new (July-August) joint PW/SPF work plan for the development of legal, methodological and analytical documents for agro-industrial privatization acceleration was approved by SPF. In accordance with the plan, PW continued assistance to SPF in drafting the procedural documents and instructions on accelerating AIC privatization, including:
 - SPF Order #730 on acceleration of share sales in APK and preparing the lists of enterprises and schedules of sales;
 - SPF instructions to the regions on invalidity of Decree #26-1992, which hampered privatization of grain industry;
 - changes and amendments to the AIC Privatization Law;
 - changes to 4 major SPF regulations on AIC privatization, etc.
- SPF issued Order #714 on additional indexation of assets of enterprises which did not perform indexation as of 01/01/95, which in some clauses contradicts to the current legislation and can complicate enterprise preparation process. PW provided SPF with analysis of this Order and recommended changes.
- PW drafted an analytical overview of legislation on peculiarities of privatization in several key branches of Ukrainian economy (energy, coal, telecom etc.)

- PW PRS experts visited 5 regions (RPFs, Oblast Administrations) in order to specify the obstacles to MPP and provide advise/assistance on enterprise preparation, AIC, Khlib Ukrainy and other issues.
- The SPF Regulation on Procedure of Preferential Sale of Shares has been approved by the SPF and submitted to the Ministry of Justice for the state registration.
- The SPF a letter to the SSMC regarding enterprise problems with the Share Issue Registration and the list of enterprises having problems with the Securities Issue Registration has been signed by the SPF and sent to the SSMC.
- Continued work on upgrading the Close Subscription Software to be implemented after state registration of the corresponding regulation.
- Started work on the SPR Regulation on Sale of 5 % of Shares to Enterprise Management for CCs and Housing Checks.

Open Issues

- “Plan Graphic” list of companies to be privatized month-by-month through the end of 1997 with 70% depth of sales to be compiled.
- Verkhovna Rada to decide to extend CC distribution until March 31, 1998.
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) to be passed (particularly after Verkhovna Rada approval of the State Budget for the Year 1997).
- The draft PW authorization letter, if signed by the appropriate SPF authority, will help to increase effectiveness of our enterprise preparation work.
- The draft joint SPF/PW technical assistance plan for August-September 1997, awaiting the signatures of SPF management, would more clearly define the tasks to assist the SPF/GOU in accomplishing their 1997 privatization targets.
- SSMCs support in streamlining the Share Issue Registration for enterprises to be privatized.
- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.
- USAID approval of the joint SPF/PW work on issues of transforming Trust Companies into Investment Funds.
- SSMC Share Issue Reregistration after share splits at certificate auctions

Progress Report
July 1 - July 31, 1997

Key Events

- The list of enterprises offering share packages for the 31th PPC auction was published by the SPF. 393 share packages being offered for sale. The highest number for 1997.
- The 17th auction for CC was launched by the SPF. 402 share packages being offered for sale. The highest number of packages ever offered for CC auctions.
- The Auction Commission approved the results of the 29th PPC auctions. 354 share packages were offered. Auction results approved for the 351 share packages. Three packages were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 146,323 which is the lowest number for 1995-97 PPC auctions. Kiev oblast's enterprises accumulated 18% of all PPCs invested. 10.3% of capital of Kiev oblast's JSC "Valsa" was sold for 25,079 PPCs (or 17.4% of all PPCs invested). Auction price of these shares exceeded by 1.8 time the nominal value. 26.3% of capital of JSC "Nezhin milk plant" was sold for 19,268 PPCs (or 13.4% of all PPCs accumulated). Auction price of these shares exceeded by 17.2 time the nominal value.
- The Auction Commission approved the results of the 14th (05/97) CC auction. 172 share packages were offered. Auction results approved for the 171 share packages. One package was withdrawn by SPF from the auction because of mistake found after publication.
- The number of winning certificates was 1,644,671 which is 3.6 times higher than that the previous 13th CC auction. 14.2% of capital of JSC "Barvnik" from Lugansk oblast was sold for 551,671 CCs (or 33.5% of all CCs invested). Auction price of these shares exceeded the nominal value by 3.6 times.

Key Outputs

Regular work \ reports

- Assisted SPF to compile and verify the information packages for the 31th PPC auction (08/97). A total of 393 (22 more than in the previous auction) share packages have been prepared, including 158 (12 less than in the previous auction) share packages of new enterprises. The average size of offered packages is 20.7% of the statutory fund.
- Assisted SPF to compile and verify the information packages for the 17th CC auction (08/97). A total of 402 (57 more than in the previous auction) share packages have been prepared, including 238 (17 more than in the previous auction) share packages of enterprises that never participated in CC auctions before. The average size of offered packages is 16.04% of the statutory fund.
- Prepared analytical notes on offered share packages for 31th PPC and 17th CC auctions.
- Provided SPF's press department with the standard PW PPC and CC auctions analytical notes.
- Identified and reported to the SPF the discrepancies in the SPF's information about total percentage of capital sold and capital sold only via PPC and CC auctions for some enterprises undergoing privatisation.
- Prepared analysis on privatisation status of ENERGO's enterprises to be privatised according to individual plans ("CoM's list").
- Updated the auction statistics files on the office network with the results of 29th PPC auction and 14th CC auction and the list of share packages offered on 31th PPC and 17th CC auctions.
- Updated the PPC and CC distribution statistics on the office network.
- Created additional standard reports on "Group D" and "Group D-large only" for enterprises which participated in PPC and CC auctions.

Special Tasks completed at request of client, MPP team and other parties

- Supplied PW's Enterprise Preparation (EP) team, SPF, IFC with the list of 1,200 enterprises which did not reach 70% sold and should be checked by RPFs for possibility to offer shares for the 17th CC auction.
- Conducted "on-line" analysis of share packages to be offered in 17th CC auction in order to report and possibly improve the quality of the forthcoming auction.
- Working with the EP team, collected in electronic format information about enterprises stopped in different privatisation stages. Provided EP team with the verified lists.
- Updated analysis on AIC enterprises status of privatisation for the SPF's AIC department.
- Updated analysis on privatisation status of AIC enterprises based on SPF's and PPC and CC auctions results data.
- Collected RPFs' reports about AIC preferential sales status and provided SPF with conclusions and recommendations.
- Prepared analytical note on methodology of compiling the list of 2500 enterprises to reach 70% sold by the end of 1997.

Data collection / verification.

- Continued to update in electronic format information about enterprises' SAPs published to date in "Investment Gazette", EE daily, Intelnews, etc.
- Continued to compile and verify list of group D enterprises.
- Continued work with the SPF's AIC and Property Reform Departments on compiling the list of companies to be privatized by RPFs and Central Office in 1997 (plan-graphics).
- Updated information about privatization status of the Cabinet of Ministers' list of enterprises.
- PW SPF consultants continued to provide general assistance to their assigned departments.
- Continued to update all the available data in order to compile the Group D enterprise list.
- Updated and verified unofficial list of the "strategic" enterprises based on data collected from CoM.

Open Issues

- Provided with access to data, PDAT could assist SPF in following tasks:
 - reclassification of groups of enterprises undergoing privatization
 - obtaining, verifying information about fixed assets of enterprises from Ministry of Statistics in order to compile the list of "large" enterprises (with fixed asset values over 170 mln UAH each)
 - creating a list of CA enterprises to be transferred from the SPF (CA) to the RPF's for sale.
 - preparing the list of 2500 enterprises which should be sold by the end of 1997.
- Absence of the lists of privatized to date enterprises makes it very difficult to predict results and to see the progress, define the goals and targets of the MP program.
- Absence of the "authorization letter" is still an issue. It causes unpredictable problems in analysis preparations and formally allows SPF not to share any data with PW.

PROJECT TEAM:

MPP SHAREHOLDER REGISTRATION PROJECT TEAM
("MPP/SRP TEAM")

Progress Report

July 1 - July 31, 1997

Key Events

- Conducted a series of meetings with PARD's president Mr. Gordienko, refining PARD Members database system specifications, and discussing strategy, terms and areas for further collaboration.
- Participated in the PARD's internal meeting to discuss functional requirements to PARD's specialists, the work of PARD's committees (including the Technical Committee) etc.
- Participated in the WB/USAID Capital Markets Meeting to discuss the draft Law on National Depository System, Derzhinvest issues and the WB EDAL II Capital Markets Conditionalities.

Key Outputs

- The SPF Regulation on the Shareholder Information Transfer from the UCCA to Issuers/Registrars has been approved by the SPF and submitted to the Ministry of Justice for the state registration.
- Developed a final version of the system specifications (functional requirements, data model, etc.) for PARD Members Database.
- An iteration (version) of PARD Members database system has been developed and installed at PARD's office for evaluation and testing purposes.
- Upon PARD's request, an IT/Shareholder Registry specialist Svetlana Dereza has been assigned a task to serve as a coordinator of the PARD's technical committee.
- Provided technical support to PARD on configuring PARD's computer telecommunications.
- Continued work on developing a standardized data transfer information format for shareholder data created in the process of Preferential Sale of Shares.
- Continued work on the joint SPF/SSMC Regulation on Procedure of the Registered Securities Owners Registry Compilation and Introduction of Changes After Each Stage of Privatization.
- Continued work on elaboration of a unified shareholder register data format to be used when the registry of a certain issuer is transferred from one registrar to another.
- Continued work on upgrading the Close Subscription Software to be implemented after state registration of the corresponding regulation.

Open Issues

- Obtaining formal feedback from PARD experts on proposed initial draft of a unified shareholder register data format to be used when the registry of a certain issuer is transferred between registrars.
- Introduction by PARD of a unified Shareholder Registry Data format to be used for registry transfer between registrars.
- Introduction by the SSMC of the simplified electronic format for the registrar quarterly reports.
- Shareholder Registry Software Certification.

Progress Report
July 1- July 31, 1997

Key Events

- The SPF offered its 8,500th share package for sale on the 31st PPC Auction (July) and increased the total number of new enterprises which have offered shares on PPC auctions to date to 5,213.
- The SPF offered its 3,500th share package for sale on the 17th CC Auction (July) and increased the total number of new enterprises which have offered shares on CC Auctions to date to 2,910.
- The SPF Order on the Sequence of Share Sales was signed by Acting SPF Chair Lanoviy on July 7th. The Order establishes quotas of total outstanding shares to be sold for PPCs and CCs, in accordance with the 1997 State Privatization Program.
- At a seminar for RPF officials on the 1997 State Privatization Program, held on July 8-9, PW distributed methodological manuals on privatization of agricultural enterprises and advised RPF officials on ways to accelerate enterprise preparation.
- PW and the SPF held the first joint roundtable meeting chaired by Mrs. Ledomska since she assumed the post of Acting SPF Deputy Chair in May 1997. The most important result from the meeting was a general agreement on joint enterprise preparation activities in the sphere of the agro-industrial complex. In addition, Acting Deputy Chair Ledomska signed a letter to the Securities and Stock Market Commission (SSMC), formally requesting assistance in overcoming privatization delays resulting from procedures on the registration of shares (for which the SSMC is responsible).

Key Outputs

Auction Preparation

- Assisted RPFs to prepare 393 enterprise information packages for the 31st PPC Auction and to transfer them to Kyiv. Of these, 158 represented enterprises which had not yet participated in PPC Auctions.
- Assisted RPFs to prepare 402 enterprise information packages for the 17th CC Auction and to transfer them to Kyiv. Of these, 238 represented enterprises which had not yet participated in CC Auctions.
- Assisted the SPF in the preparation and dissemination of auction “plan graphics” (=quotas) for upcoming PPC and CC auctions.
- On a regional level, analyzed enterprise preparedness for certificate auctions, thus facilitating regional auction planning and plan graphic compliance.
- To augment regional auction preparation assistance, the EP Team coordinated trips for auditors and other specialists to the RPFs to help them prepare enterprise information packages for the 17th CC Auction.
- Prepared a report for USAID on assistance provided to the RPFs in the preparation of enterprise information packages for recent certificate auctions, outlining the current scope of assistance and offering suggestions for enhancement.

Enterprise Preparation

- Albeit with reduced scope, continued to provide direct technical enterprise preparation assistance to 10 enterprises of Group D as well as other large enterprises of Group C.
- Conducted a series of meetings with SPF, SSMC, and CabMin officials to discuss delays in the enterprise preparation pipeline and ways to accelerate enterprise preparedness for PPC and CC auctions.

- Compiled a list of enterprises to be privatized by the Central Apparat (=SPF) and met with officials from the SPF and various Ministries to discuss acceleration of privatization plans for large enterprises from the electric power, coal, and oil and gas industries.
- Ten National SWAT Consultants made at least one trip to the regions to advise RPFs and enterprises on how to overcome persistent delays in enterprise preparation. Issues discussed included share registration, valuation, indexation, inventory, and auditing.
- Prepared a draft SPF Instruction Letter, advising Khib Ukrainy grain elevators on how to separate the strategic state reserve from private grain storage.
- Met with the RPF agricultural departments of Zaporizhe, Vinitsya, and Khmelnytsky and agreed on methods to accelerate the privatization of grain elevators.
- Continued to provide the SPF with analyses of the privatization status and progress of grain industry enterprises.

Other

- Updated regular report on the investment climate in Ukraine.
- Provided input into the development of a Mass Privatization WWW-site.

Open Issues

- The SPF continues to refuse to sign a monthly work plan or letter of joint SPF-PW-USAID cooperation, thus seriously hindering PW's efforts to streamline auction planning, to accelerate enterprise preparation/share sales in general, and to privatize large, attractive enterprises in particular. The EP Team does however continue to work under "unofficial terms" with the RPFs and SPF on these issues.
- Recent auctions have seen a decline in the number of large/attractive enterprises participating. The SPF is reportedly reserving such enterprises for cash-generating sales or is hampered in auctioning these enterprises, because of industry-specific privatization peculiarities. For example, the RPFs in Lugansk and Donetsk reported that one-third of the total number of enterprises slated for privatization in their Oblasts are coal enterprises (both mines and service businesses). The Coal Ministry has refused to release documents necessary for the privatization of these enterprises. The SPF has promised to raise this issue with the Coal Ministry directly. The EP Team intends to follow up on this issue along with a focus on other key industries currently excluded from/participating in limited fashion in the Mass Privatization Program, including energy, telecommunications, hospitality, and more.
- The Cabinet of Ministers circulated a draft resolution modifying its Resolution #1000/96, which governs the privatization of Khib Ukrainy. The draft includes a proposed list of 133 enterprises which would be required (if the draft comes into effect) to transfer their assets (as opposed to shares) to the statutory fund of Khib Ukrainy, thus creating a (non-holding) monopoly likely to dominate the grain market. Several of the enterprises included in the list are however engaged in the privatization process with EP Team assistance.

Progress Report

July 1 - July 31, 1997

Key Events

- Reorganized and restructured audit team temporarily to perform Enterprise Preparation work within the scope of the PW Acceleration of Mass Privatization efforts; team members were debriefed on current issues and general information regarding preparation of enterprises for sale and performed related work in the regions.
- Extension of PPC distribution period and potential changes in “extermination” of leftover PPCs after distribution period.
- Some structural changes took place at the UCCA:
 - ⇒ Mr. Matvienko P.G. resigned from the position of Kyiv center director and is appointed to the position of Deputy of the UCCA director;
 - ⇒ Ms. Gavrilchuk I.B. (former Kyiv RCCA Deputy director is appointed to the position of Kyiv RCCA director).

ACN Consulting/Certificate Auction Support

- Completed the ACN evaluation for June, 1997. In June the ACN earned the total amount of \$168,228. Considering the ACN debt for previous periods, the amount of \$136,358 was transferred to the UCCA for distribution among RCCAs. Three RCCAs (Kirovograd, Mykolaiv, Zakarpattya) still have a debt for the total amount of \$1,441.
- UCCA submitted to PW confirmation of money transfers to the RCCAs according the PW Instruction Letter on May ACN evaluation.
- Provided regions with the latest information on the results of the 29th PPC Auction so that RPFs could revise Share Allocation Plans (SAP) and prepare more packages for the upcoming auctions.
- Worked (jointly with PDAT) with SPF to get the information on the number of enterprises which reached 70% sold after 28 PPC and 13 CC auctions. Information was provided by the SPF: 20 enterprises reached 70% sold after 13CC, 36 enterprises reached 70% sold after 28PPC.
- Continued day-to-day consulting to the UCCA and RCCAs on operations, procedures and financing.
- Participated in the preparation of share packages for the 17th CC Auction in Ternopil region.
- Continued to support and coordinate the efforts of the ACN in the sphere of EPS. Jointly with the UCCA specialists visited the APK enterprise in Kyiv region. Met with the management (director and economist), consulted them in the issues dealt with both privatization of APK enterprises and more particular in the inventorization issues.

ACN Systems Support

- Modified list of share owners in paper and electronic formats (for PPCs and CCs) according to regulation “On transfer of data from SPF to issuers”.
- Performed routine maintenance, modifications, and user assistance for the various live systems, including CC and PPC bid collection and auction processing systems.
- Tested and documented new version of Financial Intermediaries Data Entry software package with ability to create list of people who have remainders on privatization accounts.
- Implemented minor changes in auction system reports, at the request of the UCCA.

- Installed and tested five additional satellite stations, for a total of seven fully-operational satellite stations.
- Installed new version of the regional Telecommunication utility Node 4.20, which enables the regions to send data via the satellite system.
- Tested new versions of software (regional data entry, data consolidation, verification and transfer software) for sales of leftover shares on privatization accounts.
- Tested Internet service providers and draft Web page Intranet environment, in preparation for implementing a World Wide Web site for publishing auction data results.

Monitoring ACN Activity

- Performed standard review of accounting documentation and internal controls at the Sevastopol and Odessa RCCAs (July 7 - July 11). Participated with UCCA Control Department Representatives in Exit Conference with Sevastopol and Odessa RCCAs' Management to discuss audit findings. Drafted Sevastopol and Odessa RCCAs' Audit Report of Findings. SPF individuals were invited to attend both visits but were unable to perform joint audits due to time and resource constraints.
- Prepared and documented workpapers for the Sevastopol and Odessa RCCA visits.
- Prepared for Odessa and Sevastopol RCCA visits by coordinating with UCCA, obtaining access letters, and discussing the timing of the trips with the related RCCAs (to be performed July 7 - July 11). Coordinated with the UCCA and SPF Control Departments regarding joint audits at the Sevastopol and Odessa RCCAs.
- Prepared translation of Kiev RCCA Report of Findings for distribution to USAID, UCCA and SPF representatives.
- Drafted training program for representatives of the SPF which will at a minimum be given to the SPF for internal use or presented to the SPF during a seminar, given the SPF Chairman's authorization. Prepared agenda and training manual for such purpose.
- Three audit team members traveled to eight different regions (Vinnitsa, Khmelnyvtsiy, Zakarpatie, Ivano-Frankivsk, Poltava, Chernivtsy, Rivne, Kirovograd) assist RPFs in preparing enterprises for sale and in consulting regarding questions of those enterprises which remain "in the pipeline". Drafted report of activities for review by EPS Department.

Internal Support

- Participated in discussions with EPS team regarding the possibility of the audit team assisting with the Enterprise Preparation SWAT Team and utilizing audit team members to increase the rate of privatization by consulting with RPFs in different regions.
- Participated in training seminar conducted by the EPS Department regarding enterprise share packages and the process of privatizing enterprises in preparation for audit's expanding role within EPS during this "UMPP Acceleration Period".

Problems identified, open issues requiring decision

- Prepared letter of proposal to the SPF regarding joint audits, training schedule, the SPF's increased role in performing procedures within the ACN, and reporting on findings within the ACN upon performance of these procedures in May 1997. SPF acting Chairman has not given full support to the Training proposal or assisted in implementing the plan.
- Disk storage capacity should be increased for Shareholders Database maintained in the UCCA.
- Final system testing of the ACN satellite network is not yet completed; therefore, the final payment to subcontractor "Infocom" has not been made.
- Two regional data centers are moving to a different location, and will require relocation of the corresponding satellite stations.
- SPF-PW-UCCA MOU should be discussed and signed.

- The following issues await further clarification at the SPF (as was stipulated by the Final Phase Financing Agreement, USAID/PW and the UCCA should review the Agreement in June):
 - 1-balance of the SPF and USAID assistance provided to the ACN.
 - 2-ACN involvement in the EP process.

AUGUST 1997 PROGRESS REPORT

Despite the fact that August is generally a very “slow” month in Ukraine, a number of positive new developments occurred - including some radical new initiatives proposed by the management of the State Property Fund.

Compensation Certificates

- A major surge in CC collection occurred in August.
- UAH 4,398,422 value of CC's were distributed during the month, representing 2,526,458 certificates.
- The value/number of CC's distributed in August is nearly 300% higher than the average monthly distribution during the first seven months of 1997 - and is higher than the average monthly distribution during 1996, the first year of CC auctions.
- Distribution reached the 20.2% level as of the end of August.

The surge in collection in August was driven by two major factors:

- 1) The public and financial intermediaries know that - unless the Cabinet of Ministers (who have the authority to extend CC distribution) or Verkhovna Rada approve an extension - CC distribution ends on September 30, 1997.
- 2) The public and financial intermediaries expect/hope that shares of large, attractive Group D enterprises will be offered in forthcoming CC auctions,
 - e.g. the shares of 2 giant enterprises and 2 “strategic” enterprises are being offered in the 17th CC Auction which ends on September 14;
 - More importantly, a record number, 19 Group D enterprises - including 15 new and 5 giant enterprises - will be offered in the 18th CC Auction which begins on September 15.

The increase in public interest in CC collection and an increase in the market value of CC's (which should coincide with the offering of many large, attractive Group D enterprise shares in CC auctions) should encourage the Cabinet of Ministers to extend CC distribution to the public beyond the end of this month.

It is time to again aggressively promote CC distribution/CC auctions as the single most effective privatization vehicle and as a means of providing real compensation to citizens.

MPP Update (as of 8/31/97)

- 6221 enterprises 70%+ sold since Jan 1, 1995. (*We expect the SPF to easily reach the World Bank conditionality target of 6500 enterprises privatized by 9/30/97 and the 8000 target by 12/31/97.*)
- 7455 enterprises 70%+ sold since Jan 1, 1992.
- 5340 new enterprises have participated in PPC auctions since Feb 1995.
- 3050 new enterprises have participated in CC auctions since April 1996.
- 45 million+ PPC's collected (90% of population) of which 37 million invested (82% of collected).
- 62 million+ CC's collected (20% of total available) of which 16 million invested (28% of collected).
- In the next (from mid-September) CC Auction, the SPF has approved the auctioning of 19 Group D enterprises - including 5 “giant” enterprises - a record number of largest, most attractive enterprises in a single auction.

SPF's Proposed "Measures to Complete Certificate Privatization in 1998"

The SPF has approved and presented to the Cabinet of Ministers a draft proposal for submission to the Verkhova Rada.

The draft covers "*Measures for the Completion of Certificate Privatization in 1998*". It is a radical proposal which the donors should support, which will likely be watered down by the Cabinet of Ministers, and which will more likely be emasculated by the Rada.

Key components of proposal:

- 1) CC/PPC distribution continues to 7/1/98
- 2) Housing Check distribution continues to 10/1/98
- 3) Certificate auctions continue to 12/31/98
- 4) Tradability of PPC's and HC's from 1/1/98
- 5) 1998 MPP goals are:
 - Complete preferential sales for all Group B, C, D enterprises by 10/1/98
 - Draft measures to dispose of uncollected/unused certificates by 10/1/98
 - During October - December 1998, conduct the final auctions for all uninvested certificates
 - Cancel undistributed certificates
 - Parallel certificate and cash auctions
- 6) Reduce agro-industrial sector (AIC) enterprise preferential sales period to much less than one year in order to permit employees of such enterprises to use certificates before certificate auctions end on 12/31/98
- 7) Order local authorities to proceed with/accelerate privatization of communal properties according to existing, standard procedures (i.e. do not allow local authorities to create their own privatization programs).

The SPF's proposal presented to the Cabinet of Ministers is in urgent response to the ill-conceived and revived draft proposal in the Rada to cancel PPC distribution and to turn over all undistributed PPC's to a state "Social Protection Fund" which will invest PPC's and buy shares - with earnings/dividends paid out to needy citizens.

SPF's Proposal for Demonopolization and Privatization of "Khib Ukrainy"

The SPF Chairman last week submitted to the director of Khib Ukrainy (KU), the Minister of Agriculture and the Cabinet of Ministers a radical counter proposal to the latest KU/Cabinet of Ministers' proposal for KU.

The SPF's response articulates a number of reasons why KU may have violated regulations and therefore be an illegal entity, why it impedes the development of a grain market, and provides alternative proposals to limit KU to 90 enterprises and to promote state reserve purchases in the market.

Highlights of the SPF's proposal include:

- Shares of grain storage enterprises proposed for transfer to KU under Cabinet of Ministers Resolution #1000 were not transferred by the deadline of 8/22/97 - bringing into question the legality of KU. KU exists only as an empty "shell" enterprise.
- The establishment of KU has delayed grain sector privatization by one year..
- The Ministry of Agriculture delayed the corporatization of proposed KU enterprises.
- By its commitments to World Bank EDAL II conditionalities, the SPF has already initiated privatization of KU enterprises. 236 KU enterprises have begun - or will begin before the end of

the year - privatization under plans approved by the SPF, Ministry of Agriculture, the Anti Monopoly Commission, and the Cabinet of Ministers.

- The proposed transfer of 173 grain storage enterprises to KU raises issues which must be addressed by the Anti Monopoly Commission.
- KU management may be unable to manage not only the component enterprises - but itself as well.
- The proposed role of KU will hinder the development of Ukraine's grain market, reduce competition and raise prices.

The SPF proposed alternatives for KU are:

- 1) Retain shareholdings in no more than 90 grain storage enterprises.
- 2) Establish a state agency to serve as the Government's agent for the purchase and storage of mobilization/strategic reserves via contract with the private sector outside of any reserves held by the 90 KU elevators.

This is a radically new proposal - which incorporates most or many of our proposals. Given that the issues are still being debated, it is still possible that the SPF's proposal could be accepted by the Cab Min. USAID and World Bank "encouragement" to make this happen will be critical.

Privatization and Ukraine's 200 Largest Enterprises

In August, Ukraine's *Investment Gazette* published lists of Ukraine's "Top 100" enterprises ranked according to revenues, net income, statutory capital, and volume of exports. The lists were compiled by Deloitte & Touche and are the first such accurate rankings to appear in Ukraine.

We have combined the several lists - eliminating overlaps - into one list of Ukraine's "Top 200" (actually 193) enterprises.

In order to assess the progress of privatization versus Ukraine's largest/most attractive/"crown jewels," we have prepared an analysis as to the privatization status of each of Ukraine's largest 193 enterprises. (A comprehensive analysis is being prepared by our data analysis team and will be available shortly.)

In the meantime, following are the highlights of the analysis of the progress of privatization of Ukraine's largest and most attractive 193 enterprises:

- *In general, the privatization program is well on its way to privatizing most of Ukraine's largest and most attractive enterprises. (Note: the list excludes military-industrial enterprises).*
- *150 enterprises* - or 78% - of the largest 193 enterprises are subject to privatization.
- *43 enterprises* - 22% of the total number - are on the negative list. These 43 enterprises are nearly all (85%) in the railway, nuclear power generation, and telecoms (Ukrstel) sectors.
- *Of the 150 enterprises subject to privatization, 61 were privatized prior to 1995 via employee lease/buyout schemes or were established post-1991 as privately-owned enterprises (e.g. privately owned banks). 89 enterprises have been privatized post-1995 or are undergoing share sales or preparation for share sales.*
- *70 of the 150 enterprises* have been privatized since January 1995 or are currently undergoing share sales. *39 of the 70 enterprises* are 40%+ privatized including 13 which are 100% sold.
- *Included in the 70 are several of Ukraine's largest and most viable/promising enterprises: Ukrnafta (#10 on the list, 30% privatized), Azovstal (#4 on the list, 44% privatized), Mariupol Ilycha Steel (#3 on the list, 36% privatized), Nizhnedniprovsy Pipe Rolling (#18 on the list, 100% privatized).*

- *6 of the 20 largest enterprises are “energos” and are undergoing share sales.*
- *19 of the 150 enterprises are undergoing enterprise preparation including the largest enterprise in Ukraine, Ukgazprom (in which the share allocation plan calls for the state to retain 51% of shares).*
- *The 100 largest enterprises in Ukraine account for roughly 50% of the total value of Ukraine’s industrial production and 35% of the total value of Ukraine’s exports.*
- *The vast majority of the 150 largest enterprises are in the metallurgy and energy sectors.*
- *Of the 89 enterprises undergoing share sales or preparation for share sales, 54 have participated in PPC auctions, offering between 3% and 80% of their shares.*

Accelerated Certificate and Cash Auctions of Ukraine’s Largest/Most Attractive Enterprises

On August 20, the SPF Chairman issued Order #905 which orders the SPF to revise the share allocation plans for 70 of Ukraine’s largest and most promising enterprises - including 17 energy generation and distribution companies and many of Ukraine’s largest steel and metallurgy, chemical, refining, paper, shipbuilding and machine building enterprises.

The share allocation plans have now been completed and require that each of the 70 enterprises sell at least 25% of their shares for certificates - *as required by the 1997 Privatization Program adopted by the Verkhovna Rada* - firstly in preferential sales to employees and managers and thereafter in public PPC and CC auctions as necessary to meet the 25% quota. The 1997 Privatization Program requires that all largest (so-called Group D) enterprises must first meet the 25% certificate sales quota before offering shares in cash auctions and commercial and non-commercial tenders.

The objectives of the Order are to accelerate share sales for certificates so that many of these 70 enterprises can offer shares in cash auctions before the end of 1997 in order to generate revenues for the budget.

We strongly support the objectives of the Order which will accelerate the privatization of Ukraine’s “crown jewel” enterprises by:

- *Accelerating the sale of a minimum of 25% of each enterprise’s shares via preferential sales to employees and managers and to the public in certificate auctions.*
- *Accelerating the sale of packages of shares to portfolio and strategic investors in cash auctions.*
- *Leading to the sale of large (26%+) share packages - now reserved for the state - via strategic investment tenders.*

As expected, the SPF’s Order has prompted a negative response from numerous parties who do not want such “strategic” enterprises to offer a large percentage of shares for certificates and in cash auctions but prefer instead to see large share packages offered in investment tenders to domestic and international investors. While the objectives of attracting strategic investors and new capital are certainly admirable, such tenders might well delay privatization and serve to benefit primarily “insiders”.

The SPF Chairman has thus far elected to pursue his aim of meeting certificate auction quotas and to beginning cash sales - and to then reducing shareholdings reserved for the state (e.g. the state has reserved 51% of the shares of most of each energy generation and distribution enterprise). For example, in the September PPC auction, the SPF will offer the shares of two energy companies from the list of 70 enterprises in the SPF Order and in the September CC auction the shares of several of the 70 enterprises will be offered.

The successful implementation of the SPF's Order #905 thus represents a true test of the willingness of the GOU to see the Mass Privatization Program through to completion - and to not exclude Ukraine's "crown jewels" from the program.

Ukraine's Mass Privatization Program: Transitioning to Other Forms of Share Sales

Should share packages of large, attractive enterprises (such as electric generating and distribution enterprises) be sold for certificates and cash to the market *now* (use the MPP/certificate auction program as the mechanism/basis for cash sales)?

Or be sold via "strategic tenders" (which will take many months to complete - during which time the enterprises will continue to deteriorate and to be a drain on the national budget)?

Or be sold now via "non-commercial tenders" (which attract neither strategic investors nor the levels of cash which might be generated from transparent, public, publicized cash auctions - and which generally serve to benefit only "insiders")?

The success of Ukraine's privatization program depends upon a smooth transition - for each enterprise undergoing privatization - from certificate auctions to cash auctions. The Government of Ukraine is naturally interested in quickly generating additional budget revenues through the cash auctioning of small percentages of shares (e.g. 5% to 10%) of large and relatively attractive enterprises and is interested in attracting strategic investors to strategic enterprises via the sale of large, "control" share packages.

As required by the 1997 Privatization Program and the SPF Order #701, all Group D enterprises - including the largest and most attractive approved for full or partial privatization - are to complete the sale of 25% of their shares for certificates *before* beginning cash auctions and strategic tenders.

The SPF's Order #905 of August 20, 1997 provides for the revision of the share allocation plans of 70 such large, attractive enterprises - including 17 energy generating and distribution enterprises. By law, these enterprises are to complete certificate auctions (preferential sales to employees and managers, in PPC auctions, in CC auctions) - in order to reach 25% shares sold for certificates - so that they may begin cash auctions and strategic tenders.

We believe that it is critical for Ukraine to complete its mass privatization/certificate auction program for all enterprises which have been approved for privatization. Only certificate auctions can ensure rapid and effective completion of the privatization program in 1998. The accelerated offering of share packages of large and attractive enterprises in PPC and CC auctions will permit the SPF/GOU to seamlessly transition to cash auctions and strategic tenders for shares of these enterprises.

Privatization experience in the former Soviet Union and central Europe clearly indicates the following:

- Certificate auction results are the most efficient and realistic basis for the valuation of shares of enterprises which have completed share sales for certificates and which are to begin share sales in cash auctions and strategic tenders.
- Certificate auction results are the most realistic basis for determining the attractiveness of enterprises to investors, i.e. which enterprises should offer shares in cash auctions, which enterprises should offer shares in strategic tenders and which enterprises should offer shares only for certificates.

Our experience and research tells us that those governments which are most willing to take the political and economic "risks" involved in quickly and transparently selling shares for cash - including majority share packages in the country's "strategic" enterprises, generate far greater returns in terms of budget revenue generation and initiation of industrial restructuring than those

governments which fear the consequences of such sales - and thus fail to proceed with strategic enterprise share sales.

Mass Privatization Program as a “Window of Opportunity” to Transition to Cash Auctions and Strategic Tenders

With the MPP making progress toward the Government of Ukraine’s objective of privatizing all medium and large industrial enterprises by mid-1998, the certificate auction program must not be seen as totally alien to other types of share sales but rather as a means of transitioning to cash sales and negotiated sales. Sales of shares for certificates are not contradictory to other forms of share sales.

PPC and CC auction results provide the Government of Ukraine with an empirical basis for: accurately estimating the value of enterprises which are to sell shares for cash, identifying which enterprises will be attractive and which unattractive to potential investors, and developing appropriate cash share sales mechanisms.

The MPP/certificate auctions provide a “window of opportunity” for a smooth transition (as opposed to a radical change) to cash sales. Other countries which have completed their mass privatization programs have often halted the privatization process in order to develop and secure necessary political and public support for new share sales mechanisms. This unnecessarily delays completion of privatization, delays opportunities for revenue generation by the government (during which time the government is required to continue providing subsidies to industrial enterprises), and provides those who are opposed to rapid privatization (often including enterprise directors, bureaucrats in the branch ministries and other “insiders”) the opportunity to strengthen their opposition.

As the Russian experience shows, by not applying the transparency and speed of the mass privatization/voucher auction program to the next phase of privatization involving cash tenders for strategic enterprise packages, the Russian program lost significant public support, share sales were delayed, “insiders” benefitted most, and the cash sales program has had to be redesigned more than once.

Enterprise Valuations and Ukraine’s Market Valuation Process

More than two and one-half years of PPC auctions and nearly one and one-half years of CC auctions have provided more than sufficient empirical support for the Government of Ukraine to utilize the certificate auction process as the most accurate estimate of the value and attractiveness of its enterprises.

Outside experts can provide no more accurate assessment than the hundreds of financial intermediaries/corporate investors and the millions of enterprise directors, employees and citizens who have invested their PPC’s and CC’s in Ukraine’s industrial enterprises.

We recommend that the SPF utilize PPC auction results as the basis for identifying - and separating into three categories - enterprises which are to offer shares in cash auctions. *PPC auction results can easily be employed to identify enterprises as being attractive, marginal, or unattractive to investors and as the basis for three separate criteria for conducting share sales for cash.*

Three criteria for assessing the attractiveness of enterprises for potential cash investors - and the resulting proposed three cash share sales mechanisms - are as follows:

- Each enterprise which sold 90% or more of its shares at or above nominal value in PPC auctions: *Offer shares in cash auctions with a starting price of the enterprise's nominal value as utilized in PPC auctions.*
- Each enterprise which sold from 50% to 90% of its shares offered for the first time in a PPC auction: *Offer shares in cash auctions with a starting price determined by the PPC auction price (i.e. value of PPC's bid for the enterprise's shares divided by the number of shares offered) - without applying the nominal value criteria.*
- Each enterprise which sold less than 50% of its shares offered in PPC auctions: *Sell all remaining shares in the next CC auction (i.e. such enterprises attracted little or no interest from PPC investors, will be of no interest to cash investors, and should therefore be excluded from cash auctions).*
- Any enterprise receiving no bids in a CC auction should be placed on the Government's list of proposed enterprises to be declared bankrupt and assets liquidated.

In the 29 PPC auctions conducted between January 1995 and June 1997:

- 53% of share packages offered sold 90% or more of the shares in the package *above* nominal value.
- 14% of share packages offered sold between 50% and 90% of the shares in the package *at* nominal value.
- 30% of share packages offered sold less than 50% of the shares in the package *at* nominal value.
- 3% of share packages offered received no bids.

The point is this: No new methodologies nor outside experts are needed. Using the above methodology, the Government can utilize the existing certificate auction results as the criteria for assessing the attractiveness of individual enterprises and the criteria by which remaining (post-certificate auction) shares are sold.

Use nominal value as the starting price for cash auctions of shares of attractive enterprises and use the PPC auction price as the starting price for cash auctions of shares of marginal enterprises. Shares of all unattractive enterprises (as defined above) and all unsold shares from cash auctions should be immediately offered in CC auctions.

Cash Sales of "Attractive" Enterprises

Cash sales of attractive enterprises, e.g. electric utilities ("energos"), should be conducted immediately following PPC auctions, utilizing the certificate auction nominal share values as the starting prices in such auctions. Energo enterprises - mainly generating enterprises but also distribution enterprises - are selling in the secondary market (shares sold by employees following purchase in preferential sales) at 10 to 50 times nominal value. So there is little risk that the Government will be criticized for selling these enterprises "too cheaply." It is worth noting that the one electric distribution enterprise which has offered shares in two PPC auctions - *Zhytomyroblenergo* - sold its 4% of shares offered at *31 times* nominal value.

Thus, despite the facts that: the government retains 51% ownership, the energos have huge uncollectable accounts receivable from industrial enterprises and individual consumers, the government has yet to allow energos to charge market rates (i.e. costs) to consumers, the energos need substantial new capital investment, etc, *investors still believe that the future cash flow potential of the energos outweighs these negative factors.*

It is very important for the Government to consider the following factors as it begins cash sales of “attractive” enterprises:

- Only 50+ enterprises are of real interest to international strategic investors.
Strategic investors are interested in buying majority interests or at least large (25%+) share packages in Ukgazprom, Ukrtelecom, the energos, the largest metallurgy and chemical plants, Ukrnafta, Air Ukraine and a few manufacturing enterprises.
- These 50+ enterprises should sell large share packages via qualified, cash auctions - with international investment banks/consultants hired and paid by the Government to pre-qualify investors (i.e. to select bidders who have industry experience and a long-term strategic interest in the enterprises) and to conduct the sales - and with share packages sold to the highest cash bidder.
- The 50+ internationally attractive enterprises should be marketed via an advertising campaign in the *Financial Times* or other major international business journals.
- For all large, Group D enterprises (both those considered “attractive” and those considered “marginally” attractive): *It is much better to offer shares in cash auctions now - even though most of these shares might be purchased by financial intermediaries - then to wait many months to conduct international tenders or to sell such shares in non-commercial tenders. Serious, strategic investors will purchase shares in the secondary market from intermediaries. Ukraine’s industrial redevelopment and overall economy will benefit more by selling the shares of “attractive” enterprises now - for cash in the “market.” Waiting months to begin share sales via tender to strategic investors will only continue a drain on the national budget and continued deterioration of such enterprises. And the results - of cash sales now versus strategic tenders later - will be the same.*
- For all other large, Group D enterprises: First offer share packages in one PPC auction as a means of assessing the market attractiveness of the shares. Thereafter, all shares allocated for non-commercial and commercial tenders should be sold in cash auctions (i.e. one day sales via the PFTS or in one day, sealed bid, cash tenders).
- Campaigns to attract investors in these enterprises should be targeted to Ukrainians with offshore funds and to domestic investors.
- If shares are unsold in cash auctions, offer them in CC auctions.
- If shares are still unsold, then consider liquidation of the enterprises.

In conducting cash auctions and strategic tenders, *it is very important for the Government to recognize that Ukraine is competing with many other countries for both portfolio and long-term capital investment.* There are many other countries in Central and Eastern Europe, South America, South/Southeast/East Asia, etc where international investors might put their funds. And many of these countries have a much more “investor friendly” environment and offer much less risk/more return versus Ukraine.

The point is this: Ukraine will remain at the bottom of the list for potential investors until the investment climate is improved and the negative factors eliminated/addressed. Ukraine is not

competing for international investment in isolation. The hundreds of German, Korean, US, Japanese, British, French, Dutch, Italian, Spanish, Canadian, Russian, etc multinational corporations (and the billions of dollars in offshore funds held by individual Ukrainians) which represent potential investors in Ukraine will not wait for Ukraine to create an attractive investment market. These corporations and individuals will invest their money elsewhere - in Poland, the Czech Republic, Hungary, Bulgaria, Romania, Russia - until the Government of Ukraine creates a truly attractive environment. If the Government insists on creating artificial barriers to investment - including long delays in conducting cash auctions and strategic tenders and unrealistically high enterprise valuations/floor prices - investors will go elsewhere.

In sum, it is critical that the “window of opportunity” created by the Mass Privatization certificate auction program - and the principles of the Mass Privatization Program - be applied to “Mass Cash” sales of share packages in attractive and marginally attractive enterprises and to strategic, cash tenders for 50+ strategic enterprises, i.e.:

- transparency
- speed
- market determination of share values
- cash now versus future investment commitments
- equal opportunity for all potential investors (Ukrainian citizens, financial intermediaries, foreign portfolio investors, foreign strategic investors)
- uncomplicated process

Progress Report

August 1st - August 31, 1997

Key Events/Outputs

- SPF issued order #905 which approves revised SAPs of 70 most attractive Ukrainian enterprises, including regional “energosp”, to ensure fulfillment of certificate quotas and cash sales.
- The agreed Joint SPF/PW/IFC Work Plan for August - September has been signed by all parties.
- The SPF Regulation on the Shareholder Information Transfer from the UCCA to Issuers/Registrars has been registered with the Ministry of Justice.
- The SPF Regulation on Procedure for Preferential Sale of Shares has been registered with the Ministry of Justice.
- Amendments to the SPF order on privatization of non agricultural enterprises have been registered by the Ministry of Justice.
- The meeting with the Chairman of Khliv Ukrainy has been conducted to discuss the proposed privatization and demonopolization procedures for KU. At the request of the Chairman it was agreed that PW would conduct seminars for the KU employees in Kiev and in the regions on the issues of AIC privatization.
- The SPF Order on Approval of Standard Share Allocation Plans, the SPF Regulation on the Procedures of Submitting Application for Privatization and Regulation on Privatization Committee have been submitted to the Ministry of Justice for registration.
- The SPF Order On Changes to SPF Auction’ Regulations due to the SSMC Decision on the share minimum nominal value of 1 kopijka has been approved by the SPF and submitted to the Ministry of Justice for the State Registration.
- In response to the SPF request the SSMC signed a warning letter to enterprises sabotaging their Share Issue Registration. The letters are to be distributed to the enterprises.
- The SPF Instruction on Procedure of Share Sale for the Remainders of Privatization Deposit Account has been initiated by all SPF departments and submitted for Lanovy's approval.
- SPF has applied to PW with request to assist SPF in drafting procedures of converting the trust companies into investment companies. Preliminary meeting to discuss the request has been conducted with the SPF (Vasina, Sochivko).
- ETAP Enterprise Data Input/Output Forms have been developed and submitted to the SPF for approval.
- Assisted SPF in drafting a request to VR’s Commission for Control over Privatization on the status of 5% of shares being sold to the management of enterprises for CCs - is at a preferential sale or not.
- Reviewed the draft SPF Regulation on Procedure of Sale of 5 % of a JSC's Statutory Fund to the JSC Management, introduced the necessary changes and amendments and submitted it to the SPF for review and approval.

Open Issues

- Implementation of the SPF order #905 on the sales of the large Group D enterprises.
- “Plan Graphic” list of companies to be privatized month-by-month through the end of 1997 with 70% depth of sales to be compiled.
- Verkhovna Rada to decide to extend CC distribution until March 31, 1998.
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) to be passed (particularly after Verkhovna Rada approval of the State Budget for the Year 1997).

- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.
- USAID approval of the joint SPF/PW work on issues of transforming Trust Companies into Investment Funds.
- SSMC Share Issue Reregistration after share splits at certificate auctions.
- State registration of the SPF Order on Approval of Standard Share Allocation Plans.
- State registration of the SPF Order On Changes to SPF Regulations due to the SSMC Decision on the share minimum nominal value of 1 copika.
- Approval by the SPF of the Instruction on Procedure of Share Sale for the Remainders of Privatization Deposit Account.
- Approval of the ETAP Enterprise Data Input/Output Forms and upgrading of the SPF software.

Investment Newsletter Development

Key Outputs

- within the framework of “Investment Newsletter” TF, IFC’s, internal PW, Ukrainian and international experience in publicizing enterprise-related information was reviewed;
- prepared and preliminary discussed with USAID proposals with regard to the structure of publication;
- prepared the shell of the Web Site for publicizing the “Investment Newsletter” through the Internet;
- prepared the English and Ukrainian versions of the policies and procedures reference page of the Newsletter;
- launched the survey to collect privatization and financial information at the large enterprises assisted by the EP team with the aim to publicize the information at the Newsletter.

Open Issues

- final USAID approval is needed to agree on the format of the Newsletter bearing in mind limited available resources of PW MPP team;
- streamlined procedure of USAID’s, SPF, enterprise agreement upon the information to be publicized through the Newsletter needs to be established;
- SPF’s official agreement to sponsor the publication is required.

Progress Report

August 1 - August 31, 1997

Key Events

- The list of enterprises offering share packages for the 32nd PPC auction was published by the SPF. 395 share packages being offered for sale. The highest number for 1997.
- The 18th auction for CC was launched by the SPF. 282 share packages being offered for sale. For the first time in CC auctions history 19 packages of “D” group enterprises were offered for CC auctions.
- The Auction Commission approved the results of the 30th(07/97) auctions. 371 share packages were offered. Auction results approved for all share packages.
- The number of winning certificates was 630,194 which is higher than 1997 average number. Enterprises prepared by SPF Central Office accumulated 71% of all PPCs invested.
- The Auction Commission approved the results of the 15th (05/97) CC auction. 255 share packages were offered. Auction results approved for the 250 share packages. Five packages were withdrawn by SPF from the auction because of mistake found after publication.
- The number of winning certificates was 1,152,317 which is less than the previous auction and higher than 1997 average number. 8% of capital of “Poltavskiy Glynozemyi Kombinat” from Poltava oblast was sold for 310.058 CCs (or 22.9% of all CCs invested). Auction price of these shares exceeded the nominal value by 2.4 times.

Key Outputs

Regular work / reports

- Assisted SPF to compile and verify the information packages for the 32nd PPC auction (09/97). A total of 395 (2 more than in the previous auction) share packages have been prepared, including 131 (27 less than in the previous auction) share packages of new enterprises. The average size of offered packages is 20.4% of the statutory fund.
- Assisted SPF to compile and verify the information packages for the 18th CC auction (08/97). A total of 282 (120 less than in the previous auction) share packages have been prepared, including 167 (71 less than in the previous auction) share packages of enterprises that never participated in CC auctions before. The average size of offered packages is 15.8% of the statutory fund.
- Prepared and provided SPF analytical notes on offered share packages for 32nd PPC and 18th CC auctions.
- Prepared and provided SPF with the PW analytical notes on 30th PPC and 15th CC auctions results.
- PW/SPF team continued to provide general support to the corresponding departments.
- Identified and reported to the SPF the discrepancies in the SPF’s information about total percentage of capital sold and capital sold only via PPC and CC auctions for some enterprises undergoing privatization.
- Updated analysis on privatization status of ENERGO’s enterprises to be privatized according to individual plans (“CoM’s list”).
- Updated the auction statistics files on the office network with the results of 30th PPC auction and 15th CC auction and the list of share packages offered on 32nd PPC and 18th CC auctions.
- Updated the PPC and CC distribution statistics on the office network.
- Changed old and created new additional standard reports in PW database regarding PPC and CC auctions results.

- Provided regions with the latest data on the results of 30th PPC auction and 15th CC auction to enable the RPFs to review the share allocation plans and prepare bigger number of packages for the forthcoming certificate auctions.

Special Tasks completed at request of client, MPP team and other parties

- Conducted “on-line” analysis of share packages to be offered in 18th CC auction in order to timely report to PW and SPF management and possibly improve the quality of the forthcoming auction.
- Developed a computer program which will make it possible to perform electronic accounting of the Central SPF Office enterprises which are being sold. The program is installed in the Shares Sales Systems Department.
- At the request from AIC Department formulated and sent to RPFs the lists of AIC enterprises, information on which in ETAP system is not correct or is not available.
- In the process of work on verification of 936 AIC enterprises actual privatization status together with PW Enterprises Privatization team collected in electronic format and sent to SPF information on more than 400 AIC enterprises, which had no privatization status information.
- Updated analysis on privatization status of AIC enterprises based on SPF’s and PPC and CC auctions results data as of August 28, 1997.
- At the request from AIC Department updated report on AIC preferential sales status and provided SPF with conclusions and recommendations.
- Prepared draft analysis on 193 largest Ukrainian enterprises preparation to privatization and share sales status.

Data collection / verification.

- Continued to update in electronic format information about enterprises’ SAPs published to date in “Investment Gazette”, EE daily, Intelnews, etc.
- Together with SPF compiled and verified the list of group D giant-enterprises, scheduled for privatization in 1997.
- Together with SPF continued verifying the list (received from Ministry of Statistics) of group D giant-enterprises, which are in different stages of privatization.
- Continued work with the SPF’s AIC and Property Reform Departments on verification of the list of companies to be privatized by RPFs and Central Office in 1997 (plan-graphics).
- Updated information about privatization status of the Cabinet of Ministers’ list of enterprises.
- Received, converted into electronic format and analyzed the official list of the “strategic” enterprises according to CoM Resolution # 911.
- Converted into electronic format the list of the 193 largest Ukrainian published in “Investment Gazette” on August 21, 1997.

Open Issues

- Provided with access to data, PDAT could assist SPF in following tasks:
 - reclassification of groups of enterprises undergoing privatization in accordance with 1997 privatization program requirements
 - creating a list of CA enterprises to be transferred from the SPF (CA) to the RPF’s for sale.
 - preparing the list of 2500 enterprises which should be sold by the end of 1997.
 - compiling the list of enterprises having state share contradicting to the current legislation
- Absence in PW and USAID of the lists of privatized to date enterprises and the list of 1234 enterprises privatized before 1995 makes it very difficult for PW to provide assistance to SPF related to planning and fulfilling the tasks of the MP program.

Progress Report

August 1- August 31, 1997

Key Events

- Two joint workplans for the August - September period were signed by Price Waterhouse, the International Finance Corporation, and the State Property Fund.
- The SPF issued an Order approving revised share allocation plans of 70 large, attractive enterprises which will offer shares at certificate auctions.
- The Ministry of Justice approved on August 22 joint PW/SPF recommendations for the free transfer of shares from the state to members of non-agricultural AIC enterprises.
- PW met for the first time with the director of Khlib Ukrainy (KU) and delivered a proposal for the privatization of 543 KU enterprises.
- Cabinet of Ministers issued a resolution containing the list of strategic enterprises, thus clarifying that all enterprises outside the list will not retain state shares and can be 100% sold.

Key Outputs

Auction Preparation

- Assisted RPFs to prepare 131 enterprise information packages of enterprises which had not yet participated in PPC Auctions for the 32nd PPC Auction.
- Assisted RPFs to prepare 179 enterprise information packages of enterprises which had not yet participated in CC Auctions for the 18th CC Auction.
- Assisted the SPF in the preparation and dissemination of auction quotas and criteria for the upcoming 32nd PPC and 18th CC auctions.
- Assisted the SPF and RPFs in prompt delivery and processing of the results of the 30th PPC and 15th CC Auctions.

Enterprise Preparation

- Continued to provide direct technical assistance to 12 Group D enterprises as well as to large enterprises of Group C. The first Group D enterprise prepared by PW - Sarny Bridge Parts Plant - will offer its shares at the 33rd PPC Auction (September).
- Compiled a list of 174 Central Apparatus enterprises located at various stages of preparation and met with the privatization commission heads to accelerate the inventory and valuation phases of preparation.

Information Support

- Within the framework of the Joint SPF/PW/IFC workplan, verified data on the giant Group D enterprises subject to privatization in 1997. The list of reliable data was presented to the SPF management.
- Within the framework of the Joint SPF/PW/IFC AIC privatization workplan, verified the list of 900 AIC enterprises with ETAP data inaccuracies. The ETAP data in the regions was corrected and verified.
- Compiled a list of AIC enterprises that should already have completed preferential sale in order to facilitate monitoring the privatization of AIC enterprises.

Other

- RPFs evaluated the performance of PW EPT consultants. Each RPF provided a positive evaluation of their regional consultants. The consolidated results were presented to SPF management.

- Continued to prepare materials for a series of one-day seminars on corporate governance to management of privatizing enterprises to be held at the end of September.

Open Issues

- The SPF continues to recycle share packages for certificate auctions as opposed to offering exclusively new packages for PPC. Despite PW efforts and recommendations to the contrary, the SPF continues to provide the RPF's with purely numerical targets for certificate auctions.
- The SPF has not implemented certain provisions of the joint SPF/PW/IFC work plans. For example, the SPF has not provided the donors with the list of 2500 enterprises which will reach 70% level of sales by year end. This severely complicates auction planning efforts.
- No formal endorsement was issued by the SPF regarding PW's participation in preparation to privatization of SPF Central Office enterprises.

Progress Report

August 1, 1997 - August 31, 1997

Key Events

- SPF's order #905 plans 70 attractive enterprises group "D" to offer for certificate auctions.
- NatsBank requires from the RCCAs payment for each PPC, being accepted by NatsBank. According to UCCA the SPF did not give money for this purpose.
- The decision on ACN transformation into the CJSC has not been approved yet by the SPF.
- Approval by the SPF of the SPF/PW Joint AIC Workplan.

ACN Consulting/Certificate Auction Support

- Met with the ACN management on regular basis to advise regarding PW strategic/policy developments.
- Completed the ACN evaluation for July, 1997. In July, the ACN earned a total of \$171,479. Considering the ACN debt for previous periods, the amount of \$170,038 was transferred to the UCCA for distribution among RCCAs. July is the first month that RCCAs have repaid amounts advanced to the them from USAID for the first month of the new Financing Agreement.
- UCCA submitted to PW confirmation of money transfers to the RCCAs according to the PW Instruction Letter for the June ACN evaluation.
- Provided regions with the latest information on the results of the 30th PPC Auction so that RPFs could revise Share Allocation Plans (SAP) and prepare more packages for the upcoming auctions.
- Worked (jointly with PDAT) with SPF to obtain information on the number of enterprises which reached 70% sold after 29 PPC and 14 CC auctions. Information was provided by the SPF: 24 enterprises reached 70% sold after 14 CC auctions (20% more than in the previous period); 47 enterprises reached 70% sold after 29 PPC auctions (30% more than in the previous period).
- Continued day-to-day consulting to the UCCA and RCCAs on operations, procedures and financing.
- Continued to support and coordinate the efforts of the ACN in the sphere of EPS. Updated the Enterprise Preparation Department of UCCA on new legislation and procedures in enterprise preparation sphere.

ACN Systems Support

- Completed installation, final testing, and formal acceptance of Satellite Telecommunications System. Acceptance testing involved parties from three organizations: UCCA, Infocom, and Price Waterhouse. Seven Acceptance Reports were signed: Odessa, Donetsk, Luhansk, Kharkiv, Lviv, Chernivtsy, and the UCCA.
- Discussed and signed final payment conditions for the satellite system. Infocom has received the final payment.
- Performed routine maintenance, modifications, and user assistance for the various live systems, including CC and PPC bid collection and auction processing systems.
- Implemented new versions of software (regional data entry, data consolidation, verification and transfer software) for sales of leftover shares on privatization accounts. Also modified auction calculation software for the above-mentioned reasons.
- Developed new versions of CC and PPC auction calculation software to account for changes in regulations, which now restrict splitting of shares below 1 kopeck.

- Tested recovery and restore procedures of the consolidated Shareholders Database system.

Monitoring ACN Activity

- Prepared for Vinnitsa and Lugansk RCCA visits by coordinating with UCCA, obtaining access letters, and discussing the timing of the trips with the related RCCAs. Coordinated with the UCCA and SPF Control Departments regarding joint audits at the Vinnitsa and Lugansk RCCAs.
- Performed standard review of accounting documentation and internal controls at the Lugansk and Vinnitsa RCCAs. Participated with UCCA Control Department Representatives in Exit Conference with Lugansk and Vinnitsa RCCAs' Management (UCCA representative participated in meeting) to discuss audit findings. Drafted Lugansk and Vinnitsa RCCAs Audit Report of Findings. SPF individuals were invited to attend both visits but were unable to perform joint audits due to time and resource constraints.
- Prepared and documented workpapers for the Vinnitsa and Lugansk RCCA visits.
- Prepared draft Audit Report of Findings for the Odessa and Sevastopol Report of Findings. Performed first technical review of the Odessa Report of Findings. Performed final technical review of the Kharkiv Audit Report of Findings.
- Began preparing for the UCCA audit to be performed in September. Reviewed previous audit programs and work performed to determine whether procedures should be altered.
- Audit team members assisted RPFs in preparing enterprises for sale and in consulting regarding questions of those enterprises which remain "in the pipeline". Drafted report of activities for review by EPS Department. Participated in EPS training regarding Enterprise Preparation.

Problems identified, open issues requiring decision

- A hard disk has failed at the UCCA on which the Shareholders Database information is stored. This must be replaced urgently, as the system is approaching full capacity. This disk failure has highlighted the need to ensure that the UCCA is following safe backup and security procedures. In addition, methods of archiving data will be investigated.
- Training and assistance to the SPF regarding audit procedures and writing of reports apparently has not been given priority by the SPF currently due to pressures to increase the number and quality of enterprises auctioned.

SEPTEMBER 1997 PROGRESS REPORT

Following are major developments of the past several weeks in Ukraine's privatization program and as undertaken by the PW mass privatization project team:

⇒ Compensation Certificate (CC) and Privatization Certificate (PPC) Distribution Extended
Parliament passed a resolution (with no conditions attached) to extend distribution of both types of certificates - beyond the existing September 30 deadline - to December 31, 1997.

⇒ Major Increase in CC and PPC Distribution in September
Because the public had expected that CC and PPC distribution might end on September 30 - and because a record number of largest enterprises were offered in the CC auction which began in mid-September, CC collection by the public in September increased by 146% over the August level. 10.8 million CC's were distributed during the month. The total volume of CC distribution now stands at nearly 25% (of the total number of CC's available for distribution).

PPC collection by the public in September also rapidly increased - by 144% over the August level. 309,000 PPC's were distributed during the month. A total of 90% of the public have now collected their PPC's.

⇒ Privatization of Ukraine's Largest ("Giant") Industrial Enterprises
The World Bank's draft EDAL II conditionalities require that an increasing number (to be determined) of Ukraine's largest industrial enterprises reach a minimum of 40% shares sold in order to meet tranche conditionalities. As a pre-condition, the State Property Fund is required to prepare a list of the universe of Ukraine's largest enterprises (i.e., those which are approved for privatization and which are classified as "giant" enterprises - those with fixed assets in excess of UAH 170 million) as of January 1, 1997.

Because the only universal source of data for the list is often unreliable Ministry of Statistics data, the SPF agreed with the proposal of the PW team to utilize the latter's regional consultants to confirm directly with the enterprises the data included in the draft Ministry of Statistics' list and via the Regional SPF branches and the regional Ministry of Statistics branches. This task was carried out during the month.

The result is the list of Ukraine's 197 largest enterprises which have been approved for privatization (i.e. enterprises included on Parliament's negative list are not included.)

A summary analysis of the list of Ukraine's largest enterprises subject to privatization provides the following status report:

Of the 155 giant enterprises for which verified share sales data is available:

- * 57 enterprises or 37% have sold more than 40% of their shares.
- * 35 enterprises or 23% have sold more than 70% of their shares.
- * 106 enterprises or 68% have participated in public PPC/CC auctions.

Of the additional 42 enterprises (including 11 electric power distribution companies and 1 generating company) on the list, complete share sales data is yet to be confirmed. However, it is confirmed that these enterprises are in the share sales preparation stage, are conducting preferential sales to employees (as in the case of the electric utilities) or were privatized prior to 1995.

In general, the data is both positive and encouraging, i.e. the majority of Ukraine's largest industrial enterprises (excluding those - primarily railways, atomic power plants and telecoms related enterprises - on the privatization negative list) are in the process of share sales or have nearly completed privatization.

At the same time, the numbers clearly indicate that the GOU/Cabinet of Ministers/SPF need to initiate and/or rapidly accelerate share sales of many of these largest enterprises via strategic investment tenders, in cash auctions and in public PPC and CC auctions. An estimated 70% of the 197 enterprises in the universe of giant enterprises have either not begun share sales or have sold less than 40% of shares.

⇒ Ukraine's "Fortune" 200

In August, a "Big 6" international accounting firm prepared a reliable list of Ukraine's largest industrial enterprises in terms of revenues and capitalization. As opposed to the list above, this list includes all types of enterprises, i.e. those approved for privatization, those not approved, and those (few) which were never state-owned.

An analysis of the enterprises on the list - in terms of their privatization status - provides a comprehensive overview of Ukraine's progress in privatizing its industrial economy:

- * 73% of the enterprises on the list are subject to and are in various stages of privatization: 63 enterprises - or 45% of those privatizable - have sold more than 40% of their shares including 24 enterprises which have sold 75% to 100% of their shares.
- * 55 of the enterprises approved for privatization have participated in public PPC auctions.
- * 22% of Ukraine's largest industrial enterprises are included in Parliament's privatization negative list. Nearly all of these enterprises are in the rail transport, atomic power and telecoms industries.
- * 5% of the enterprises on the list are privately owned (i.e. were never state owned).
- * Again, the "Fortune" 200 list indicates that Ukraine's "crown jewels" are generally not excluded from the privatization program, that the GOU has made significant progress in privatizing its largest industrial enterprises, and that the GOU must now move to increase the depth of share sales of such enterprises via tenders for international strategic investors with smaller packages of shares offered in cash auctions and to the public in PPC and CC auctions.

⇒ State Property Fund Order #905 (*accelerated and standardized share sales for Ukraine's "crown jewels/blue chips" - including energy generation and distribution companies*)

In August, the SPF management issued Order #905 which ordered the SPF to immediately revise the share sales allocation plans of 70 of Ukraine's largest and most attractive enterprises - including 17 electric generation and distribution companies and large steel, chemical, refining, paper, shipbuilding and machine building enterprises. The Order required that the share allocation plans follow the requirements of Parliament's 1997 Privatization Program for Ukraine's largest enterprises (*without exception to industrial sector*) with at least 25% of shares first be sold to employees and the public for certificates.

The intention of the Order was to accelerate share sales for certificates in order to begin cash auctions (via Ukraine stock markets) of small parcels of shares as a means to raise revenues for the budget prior to yearend and to accelerate sales of large parcels (26%+) to strategic investors in commercial tenders. In implementation of the Order, the SPF management revised the share allocation

plans of the 70 large enterprises to provide for standardized share sales and to reduce state retained shareholdings to 26% or 51% of each enterprise.

The Ministry of Energy strongly objected to the Order. The Ministry sought to develop its own privatization plan for the electric generation and distribution companies included in the Order and to avoid following the requirements of the 1997 Program. The Ministry proposed to retain 51% state ownership in the generation companies, to reduce or eliminate share sales to the public in certificate auctions and in cash auctions via stock exchanges.

The Ministry of Energy was able to persuade the Cabinet of Ministers and the Prime Minister to pressure the SPF management to cancel Order #905. The Order was in fact cancelled on October 8 by order of the SPF Chairman. The Ministry of Energy has succeeded in excluding the four electric generating companies and 18 of the regional electric distribution companies from the conditions proposed under the Order.

On September 23, the Ministry of Energy issued its proposed law for privatization of the energy sector. The Ministry's draft proposal, "Law of Ukraine on Peculiarities of Fuel and Energy Sector Complex Enterprise Privatization," is under review by the SPF and the Cabinet of Ministers and has been submitted to the Verkhovna Rada for consideration.

The draft Law would - as was done with the agro-industrial sector - provide for a unique privatization program for the electric utility and oil and gas industry. The Law is clearly unnecessary and an impediment to privatization of the industry as the 1997 Privatization Program provides for a rapid and viable (for the industry) framework for privatization of the energy sector.

The major impact of the draft energy sector Law would be to provide insiders in the Ministry of Energy with special privileges to purchase shares, to retain direct and indirect state control over the entire energy sector, and to allow for the state and insiders to create "vertically" integrated oil and gas production, storage and distribution enterprises (a la "Khib Ukrainy").

This is the bad news.

The PW team is working with the SPF to promote the early rejection of either the entire Ministry of Energy draft privatization law - or at least its most negative aspects - and the rapid implementation of the 25% quota and tenders for majority share packages to strategic investors.

As the Ministry of Energy draft privatization law is already on the agenda of the Verkhovna Rada for consideration, we strongly encourage the donors and their consultants to encourage their counterparts in the Ministry of Energy, the SPF, and the Cabinet of Ministers to, at a minimum, propose that the draft law incorporate the strategic investor tender proposals as drafted by Schrodgers/British Know How Fund and generally endorsed by the donors.

While the donors are debating what sort of strategy to promote, the GOU and the Parliament may well adopt legislation governing privatization of/investment in the energy sector over the next few weeks which will be extremely difficult to modify after the fact.

The good news is that, while the four electric generating companies and 16 of the regional electric distribution companies have been excluded from the conditions proposed by the SPF's Order #905, the Order is in effect being applied to the other 50 enterprises included in the original Order, i.e

- * The share allocation plans of 24 (including 9 electric power distribution companies) of the original 70 enterprises have recently been approved by the SPF and the Cabinet of Ministers and provide for 25% of shares of each enterprise to be sold to employees and to the public in certificate auctions, small share packages (5% to 10%) to be sold for cash before yearend via local stock exchanges, 26%+ to be sold to strategic investors in commercial tenders, and a maximum of 26% (and not 51%) to be (temporarily?) retained by the state.
- * The share allocation plans for the other 26 remaining enterprises - with similar conditions - have been approved by the SPF and are expected to be approved by the Cabinet of Ministers this week or next.
- * *It should be noted that share sales for nearly all of the “energors” have already begun. Shares are being sold to employees under the 25% quota - with several energors currently offering shares in PPC auctions. Shares of such energors as Dniproenergo, Kyivoblenergo, Zhyromyoblenergo, Donbasenergo and Ternopilenergo are among the most actively traded shares on the PFTS (OTC) secondary market - where they trade at 5 to 10 times their initial nominal value price to employees.*

In brief, other major developments during the month:

October PPC Auction: 137 new enterprises and a total of 370 share packages were prepared for the auction including 17 Group D enterprises and 2 giant enterprises. *It is important to note that this is the first PPC auction for which the SPF agreed to utilize the PW team’s auction planning proposal: Instead of the SPF HQ ordering each Regional SPF office to deliver a certain number of enterprise share packages (new or old) for the auction, the RPF’s - with PW consultant assistance - delivered new enterprise share packages to Kyiv based on the actual number of new enterprises prepared for PPC auctioning.*

October CC Auction: 297 share packages were prepared for the auction including share packages for 157 enterprises which will generate > 70% shares sold for each enterprise. Shares of 11 Group D enterprises and two giant enterprises will be offered in the auction.

“Khllyb Ukrainy” Privatization: The “radical” proposal of the SPF Chairman is still under fire by the Min Agro/Khllyb Ukrainy/agro lobby - who are promoting their various proposals to retain large share holdings in all attractive grain elevators and storage/processing plants. Despite the uncertainty as to the future of KU, 109 KU enterprises have to date elected to initiate the privatization process (i.e. 40 are preparing for share sales and 69 have begun share sales - including 50 which have sold >70% of their shares). *The PW team conducted privatization preparation training seminars for dozens of KU enterprise managers in Kyiv and four major agro-industrial regions in August and September.*

Corporate Governance Training Seminars: During the month of September and in early October, the PW team provided one day corporate governance training seminars for the directors of more than 200 large, privatizing, industrial enterprises in Kyiv, Donetsk, Dnipropetrovsk, Lviv, Odesa and Zaporizhia.

Privatization Training for the Directors of the (USAID-supported) Bosnia Privatization Agency: During the last week of September, the PW team conducted - with the participation of officials of the SPF, UCCA, Kyiv Auction Center, Securities Commission, Cabinet of Ministers, and other government agencies as well as investment funds and other privatization consultants - in-depth

strategy, policy/procedures, enterprise preparation, IT, audit, and shareholder registration training for the management of the Bosnian privatization agency.

6500 Medium/Large Enterprises Privatized: The SPF management announced that, as of October 1, 6500 medium/large industrial enterprises reached > 70% shares sold (since Jan 1, 1995). We propose that, in addition to announcing the overall figure, the SPF/GOU should publish the actual list of all 6500 enterprises - as a service to the credibility of the privatization program, to the public and to potential domestic and international investors. The SPF expects that 10,000 medium/large enterprises can be privatized (> 70% shares sold) by Dec 31, 1997 (since Jan 1, 1992).

Bankruptcy/Liquidation: While outside our scope of work, we believe that - along with promoting access to new investors/management and new sources of capital by those most promising and attractive privatized enterprises, it is appropriate to begin encouraging and assisting the GOU to implement a more radical and aggressive policy for legally declaring bankrupt and liquidating/redeploying the assets of those hundreds/thousands of medium/large enterprises which are - in all but name - effectively bankrupt. The allocation of state resources in support of such enterprises will not end with privatization unless the final step - liquidation - is implemented and state financial support for such enterprises redeployed to provide a safety net for terminated employees. *The ultimate success of the privatization process depends upon the state's (and this includes both the government and the Parliament) recognition that plans to revitalize its industrial "dinosaurs" is, in fact, a myth.*

1998 Privatization Program: The PW team is working closely with the SPF management to draft a radical program - for eventual submission to the Parliament - which will not only ensure continuation of the generally positive 1997 Program but will provide for accelerated completion of privatization in 1998 - with the participation of international strategic investors - and reductions in state shareholdings to all but a few "national security" enterprises.

Auction Center Network Financing: In addition to the \$862,000 in USAID performance-based funding received by the ACN during the April - August 1997 period, the UCCA/ACN received \$3,700,000 in "extra-budget" funding from the GOU/SPF during January - July 1997.

GOU funding has reached a level which is in excess of the actual payroll, rent and incidental expense needs of the ACN and - based upon Ukrainian legislation which allows the ACN to receive up to 10% of GOU privatization proceeds - the UCCA/ACN is likely to receive higher levels of GOU support in 1998 (i.e. privatization revenues will increase as shares of most attractive enterprises are sold for cash).

We will therefore be proposing to USAID that all financial assistance to the UCCA/Auction Center Network terminate as of December 1997. At the same time, we will request USAID assistance in securing agreement with the Chairman of the SPF for the PW team to be allowed to conduct - jointly with the SPF - certificate auction audits of the ACN and audits to ensure appropriate utilization of USAID equipment by the ACN.

Attached please find more detailed monthly progress reports by the PW strategy/policy, data analysis, enterprise preparation, IT, shareholder registration, and audit teams.

Progress Report

September 1 - September 31, 1997

Key Events/Outputs

- Cabinet of Ministers adopted the new procedure of Approving by Cabinet of Ministers the Privatization of the Objects of State Property. In accordance with the newly approved regulation, Cab Min will have to approve only the size of the statutory fund of the privatized companies of group D and the size of the share package to be reserved by the state - and will not be able to modify the standard share allocation plans required by the 1997 Privatization Program..
- The President vetoed the “Law on Circulation of Undistributed Certificates and Creation of the Social Protection Fund”.
- SPF Order #905 which provided for the revision of share allocation plans of 70 largest and very attractive Ukrainian enterprises (including “energoholdings”) has been terminated under the pressure from Cabinet of Ministers/Ministry of Energy.
- SPF drafted and submitted to the Cab Min a draft Concept of the “Second Stage of Privatization” which calls for extension of certificate privatization until the end of 1998 and gradual transition to cash privatization.
- Based on the SPF proposal, Verkhovna Rada approved resolution to extend PPC and CC distribution and circulation until the end of 1997.
- By joint efforts of SPF Department of Privatization Program and PW, the first draft of the 1998 Privatization Program has been prepared and distributed to the branch ministries for comment.
- Draft SPF/SSMC regulation on the procedures of “Registration of the JSCs’ Share Issues to Record the Statutory Fund Increase due to Indexation of the Fixed Assets” has been reviewed by PW specialists.
- Legal analysis of the possibility to sell shares at the price below nominal value has been prepared.
- SPF “Instruction on Sales of Shares for the Remainders of the Privatization Deposit Accounts” has been approved. The first sales under the newly approved procedures have been scheduled for October.
- At the request of the SPF, PW conducted the joint meeting with SPF Department of Development of Securities Market (Ms. Vasina) with FMI to discuss the issues related to the conversion of trust companies into investment companies and possibility of creating of Inter Ministerial Commission to Protect Shareholder Rights as proposed by the SPF.
- Reviewed the present status of availability of information regarding the number of invested PPCs and CCs and proposed to create a task force to develop procedures of proper accounting for invested certificates.
- The new joint work plan between the SPF and PW for the period of October - November has been drafted and submitted to the SPF for approval.
- At the request of Mr Grigorenko (Privatization Assistant to the Prime Minister of Ukraine) participated in the meeting with Khliv Ukrainy in the office of Mr Grigorenko to discuss the possible mutually acceptable version of the Cab Min draft Resolution on Khliv Ukrainy demonopolization.
- Finalized the draft regulation on privatization of “Sovkhoses” and other agro enterprises.
- Conducted presentation to the directors and chief accountants of the Khliv Ukrainy enterprises at the seminar in Donetsk on the privatization of the grain industry.
- The team coordinated organization of the training seminar for delegation of the Privatization Agency of the Federation of Bosnia and Hercegovina. PW team members prepared and delivered presentations to the Bosnian delegation on the history and legal framework of the Ukrainian Mass

Privatization Program, role of financial intermediaries, shareholder registration, and other strategy/policy issues. Within the framework of the seminar, organized meeting with the SPF Deputy Chairman (Mr. Vasiliev), Department Director (Mr Grishan), Cab Min Privatization Department Director (Mr. Sherbina), SSMC Deputy Chairman (Mr. Romashko), UMREP program team, and Presidential Economic Advisor (Mr. Paskhaver).

Open Issues

Unfortunately some of the open issues mentioned in our September report remained unresolved:

- “Plan Graphic” list of companies to be privatized month-by-month through the end of 1997 with 70% depth of sales to be compiled.
- Verkhovna Rada to decide to extend CC distribution until March 31, 1998 (this remains an issue since CC distribution has been extended only until the end of this year).
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) to be passed (particularly after Verkhovna Rada approval of the State Budget for the Year 1997).
- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.
- Development of the simplified procedures for Share Issue Reregistration after share splits at certificate auctions.
- Though SPF Order #905 has been officially terminated, SPF should develop implementation procedures for sales of big, strategic enterprises in accordance with the requirements of 1997 Privatization Program and the Privatization Law.
- Finalize Cab Min Resolution on demonopolization of Khib Ukrainy.

Progress Report

September 1 - September 30, 1997

Key Events

- The list of enterprises offering share lots for the 33rd (October 1997) PPC auction was published by the SPF. 370 share lots being offered for sale.
- The Auction Commission approved the results of the 31st (August 1997) auction. 393 share lots were offered. Auction results approved for 389 share lots. Four lots were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 266,866 which is second lowest number in 1997. Enterprises prepared by Donetsk and Kiev RPFs accumulated 46% of all PPCs invested. Central Apparatus Enterprises accumulated only 2.8% of all PPCs invested.
- The Auction Commission approved the results of the 16th (June 1997) CC auction. 345 share lots were offered. Auction results approved for the 340 share packages. Five lots were withdrawn by SPF from the auction because of mistakes found after publication.
- The number of winning certificates was 888,863 which is less than the two previous auctions. 5% of capital of "Central Group of Mines" from Dnepropetrovsk oblast was sold for 161,207 CCs (or 18.1% of all CCs invested).

Key Outputs

Analytical Projects and Reports

- Assisted SPF to compile and verify the information lots for the 33rd PPC auction (October 1997). A total of 370 (25 less than in the previous auction) share lots have been prepared, including 137 (6 more than in the previous auction) share lots of new enterprises. 279 share lots out of 370 (75%) are lots of groups B,C or D enterprises. 96 share lots of large scale enterprises are new at the PPC auctions. The average size of offered lots is 20% of the statutory fund.
- Assisted SPF to compile and verify the information lots for the 19th CC auction (October 1997).
- Prepared and provided SPF analytical notes on offered share lots for 33rd PPC auction.
- Prepared and provided SPF with the PW analytical notes on 16th CC auctions results.
- PW team continued to provide in-house, full-time, analytical support to several SPF departments.
- Identified and prepared draft report to the SPF about the discrepancies in the SPF's and UCCA's databases.
- Updated analysis on privatisation status of "energос" and other enterprises to be privatized according to individual Cab Min plans ("CoM's list").
- Updated the auction statistics files on the office network with the results of 31st PPC auction and 16th CC auction and list of enterprises offered in 33rd PPC auction.
- Updated the PPC and CC distribution statistics on the office network.
- Continued to work on creating new standard reports in PW database regarding PPC and CC auctions results.
- Provided regions with the latest data on the results of 31st PPC auction and 16th CC auction to enable the Regional Property Funds to review the share allocation plans and prepare larger number of lots for the forthcoming certificate auctions.

Special tasks completed at request of SPF, MPP team and other parties:

- At the request of Share Sales Department of SPF, formulated and sent to RPFs the lists of Agro Industrial Complex (AIC) enterprises which were to finish preferential sales and did not reach 70% sold.

- Started new regular reporting to SPF and USAID on number of enterprises sold 70%+ via PPC and CC certificate auctions.
- Updated analysis on privatization status of AIC enterprises based on SPF and PPC and CC auction results data as of September 30, 1997.
- Started new regular reporting to AIC department of SPF and USAID on number of AIC enterprises entering privatization process and those which have sold 70%+, broken down by groups and industries.
- At the request of SPF AIC Department, updated report on AIC preferential sales status and provided SPF with conclusions and recommendations.
- Started compilation and verification of list of all 800 Khlib Ukrainy enterprises.
- Together with SPF and PW Enterprise Preparation team and based on SPF information, compiled and began to verify the list of all enterprises with value of fixed assets >170 million UAH in order to clarify the total number of such “giant” enterprises.

Privatization data collection/verification.

- Continued to update in electronic format information about enterprises’ Share Allocation Plans published to date in “Investment Gazette”, EE daily, Intelnews, etc.
- Together with SPF, continued verifying the list (received from Ministry of Statistics) of group D giant-enterprises, which are in different stages of privatization.
- Prepared report on findings done during verification of list of group D-giant enterprises for SPF.
- Received updated information on privatization status of strategic enterprises (list of CoM’s Regulation #911 enterprises). Prepared draft analysis of such enterprises for SPF, CoM and USAID.
- Started to compile updated list of enterprises to be privatized including recent changes per SPF Order #1050 of 09/30/97.

Open Issues

- If provided with access to data and SPF support, the PW PDAT team could assist the SPF in the following tasks:
 - creating a list of largest, Central Office enterprises to be transferred from the SPF (Central Office) to the RPF’s for sale.
 - preparing the list of 2500 enterprises which should be sold between mid-1997 and the end of the year.
- Absence in PW and USAID of the lists of privatized to date enterprises and the list of 1234 enterprises privatized before 1995 makes it very difficult for PW to provide assistance to SPF related to planning and fulfilling our MPP task order. Such information should be readily provided not only to USAID/PW but to the public.

Progress Report

September 1 - September 30, 1997

Key Events

- EP-related tasks of the two joint SPF/PW/IFC workplans (both AIC and non-AIC) for the August - September period were successfully implemented.
- The SPF revised the share allocation plans for all energy industry enterprises.
- On September 21, the Cabinet of Ministers issued a Resolution (#911) declaring that 227 enterprises are strategically important and will retain some state share. It also stated that enterprises not on this list should proceed with the privatization process.
- On September 18, the CabMin issued a Resolution (#1035) to simplify the approval procedures for Group D enterprises and to establish procedures for privatizing monopolist enterprises.

Key Outputs

Auction Preparation

- Assisted RPFs to prepare 137 enterprise information packages of enterprises which had not yet participated in PPC Auctions for the 33rd PPC Auction.
- Assisted RPFs to prepare 159 enterprise information packages of enterprises which had not yet participated in CC Auctions for the 19th CC Auction.
- Assisted the SPF in the preparation and dissemination of auction quotas for the upcoming 33rd PPC and 19th CC auctions.
- Assisted the SPF and RPF's in prompt delivery and processing the results of the 31st PPC and 16th CC Auctions.

Enterprise Preparation

- Continued to provide direct technical assistance to 12 Group D enterprises as well as to large enterprises of Group C.
- EP consultants agreed with the SPF to provide assistance to 8 additional Central Apparatus enterprises located at the inventory and valuation phases of enterprise preparation thus increasing the total number of Central Apparatus enterprises provided with PW assistance to 16.
- New monthly workplans were drafted and submitted to the State Property Fund for discussion and approval, as was an implementation report for the AIC August-September workplan.
- Zoanne Nelson (PW Washington) and a small team of local PW privatization experts conducted three seminars this month to encourage directors and chief economists to accelerate the privatization of their enterprises. Over 100 enterprises attended the three seminars, including 15 Group D enterprises. The seminars addressed shareholder rights, business restructuring, and raising capital. Three additional seminars are planned for October. An English-language version of the training manual will be delivered to USAID in early October.

Information Support

- Regional consultants analyzed a list of 600 AIC enterprises that should complete preferential sales by the end of the year. Approximately 40% of these enterprises must complete the free transfer of shares and sell all remaining shares by the end of the year. The SPF considers these enterprises essential to reaching their target of 8,000 enterprises privatized by year end. Price Waterhouse, the SPF and UMREP together designed and launched a public information campaign to accelerate the privatization of these enterprises.
- Price Waterhouse regional consultants, at the request of the SPF, began to verify precisely which of the 800 enterprises in the grain industry have started share sales.

Other

- PW consultants delivered the last in a series of four seminars to the Kiev employees of Khib Ukrainy. Subjects included the peculiarities of AIC legislation, valuation techniques, regional experiences, and the Ukrainian grain market. Chemonics and IFC representatives also participated on a limited basis.
- Our agro-industrial and legal experts conducted 4 one-day seminars on the privatization of Khib Ukrainy enterprises in Odessa, Mykolaiv, Kherson and Donetsk. Future seminars will be held in L'viv, Chernigiv and Poltava in October and November.

Open Issues

- The SPF continues to recycle share packages for certificate auctions as opposed to offering exclusively new packages for PPC. Despite our efforts, the SPF continues to provide the RPF's with numerical targets for property certificate auctions.
- The SPF has not implemented certain provisions of the joint SPF/PW/IFC work plans. For example, the SPF has not provided PW with the list of 2500 enterprises which will reach 70% level of sales by year end. This severely complicates PW auction planning efforts.

Progress Report

September 1 - September 30, 1997

Key Events

- Verkhovna Rada approved certificate distribution to 1997 yearend.
- The decision on Auction Center Network (ACN) transformation into the Closed Joint Stock Company status has not been approved by the SPF.

ACN Consulting/Certificate Auction Support

- Met with the ACN management on regular basis to advise regarding PW and MPP strategic/policy developments.
- Completed the ACN evaluation for August 1997. In August, the ACN earned a total of \$154,141. ACN reached 100% of the target only in the category “number of PPC’s collected”. The least percentage (13%) of the target reached by the ACN was in the category “number of CC’s collected”.
- UCCA submitted to PW confirmation of fund transfers to the RCCAs according to the PW Instruction Letter for the August ACN evaluation.
- Provided regions with the latest information on the results of the 31st PPC Auction so that RPFs could revise Share Allocation Plans (SAP’s) and prepare more packages for the upcoming auctions.
- Worked (jointly with PW PDAT team) with SPF to obtain information on the number of enterprises which reached 70% sold after 30th PPC and 15th CC auctions. Information was provided by the SPF: 43 enterprises reached 70% sold after 15th CC auction (56% more than in the previous period); 65 enterprises reached 70% sold after 30th PPC auctions (72% more than in the previous period).
- Continued day-to-day consulting to the UCCA and RCCAs on operations, procedures and financing.

ACN Systems Support

- Completed installation, final testing, and formal acceptance of Satellite Telecommunications System in 7 regions (Odessa, Donetsk, Luhansk, Kharkiv, Lviv, Chernivtsy, Dnipropetrovsk) and UCCA (Kyiv).
- Added new feature to the regional telecommunications software: possibility to work with Windows FTP software. The software was tested and data transfer speed was increased.
- Allocated the Satellite Station, CISCO router and telecommunications Server in separate segments to provide maximum security and to improve the quality of the local network.
- Continued routine maintenance, modifications, and user assistance for the various production systems, including CC and PPC bid collection and auction processing systems.
- Delivered new versions of software (data consolidation and verification software) for sales of leftover shares on privatization accounts (with instruction). Modified auction calculation software for PPC’s and CC’s systems. Also added converter from ASCII into DBF format according to the regulation on the share owners data transfer to SPF and issuers.
- Added changes related to the restriction in splitting to not less than 1 kopeck and related to the regulation on the leftovers’ share sales into new versions of CC and PPC auction calculation software.
- Resolved the problems with DEPO system in Kyiv RCCA after accidental interruption (due to user error and shortage of disk space) of archiving and retrieval processes.

- Replaced old failed hard disk with a new hard disk for the hardware of the consolidated Shareholders Database system in UCCA. This system is completely functional.
- Installed new KIEV-NTS3 LN server (4.5 version) in MPP office, and trained MPP staff.
- Prepared materials for Bosnian delegation's training.

Monitoring ACN Activity

- Performed review of accounting documentation and internal controls at the Dnipropetrovsk and UCCA. Additional audit procedures were performed at the UCCA to assess whether action results are calculated in compliance with applicable regulation.
- Participated with UCCA Control Department Representatives in Exit Conference with Dnipropetrovsk RCCAs' Management to discuss audit findings. SPF individuals were invited to attend both visits but were unable to perform joint audits due to time and resource constraints.
- Prepared and documented workpapers for the Dnipropetrovsk and UCCA audit.
- Prepared drafts Audit Report of Findings for the Dnipropetrovsk and UCCA.. Performed first technical review of the Vinnitsa and Lugansk Report of Findings. Performed final technical review of the Odessa Audit Report of Findings
- Schedule for RCCAs joint audits for period of October 97 - January 98 was coordinated with the UCCA and SPF Control Departments regarding the timing of the trips to the related RCCAs.
- Began preparing for the Lutsk RCCA audit by coordinating with UCCA, review previous audit programs and work performed to determine whether procedures should be altered.
- Started preparation of materials for training seminar for SPF regarding audit procedures and writing of reports to be conducted in October.

OCTOBER 1997 PROGRESS REPORT

Value of shares of Ukraine's medium/large enterprises sold to date via the Mass Privatization Program:

Nominal/book value (based on Government of Ukraine/State Property Fund valuations):

- 1) Nominal value of total statutory capital sold to date: *UAH 17.8 billion (@US\$9.9 billion)*
- 2) Nominal value of statutory capital sold to date in PPC/CC certificate auctions: *UAH 5.9 billion (@US\$3.3 billion)*
- 3) Nominal value of statutory capital sold to date in preferential sales to employees and in non-commercial tenders for certificates: *UAH 11.9 billion (@US\$6.6 billion)*

Cash/market value (based on average market price paid by financial intermediaries for one PPC):

- 1) Market value of all shares sold to date via MPP: *US\$3.16 billion*
- 2) Market value of all shares sold to date via PPC/CC certificate auctions: *US\$1.06 billion*
- 3) Market value of all shares sold to date via preferential sales and non-commercial tenders for certificates: *US\$2.1 billion*

Ukraine's MPP: 40% of the shares of all privatized enterprises sold to date via the Mass Privatization/Certificate Auction Program

- *38.9% of the shares of the 7740 medium/large enterprises privatized since Jan 1, 1992 (as of Oct 1, 1997) were sold via the Mass Privatization/Certificate Auction Program (in preferential sales to employees, in public PPC auctions and in public CC auctions). (This figure excludes shares sold for certificates in non-commercial tenders.)*

Khlib Ukrainy Demonopolization/Privatization Resolution approved by Prime Minister

During the first week of November, the Prime Minister approved a compromise Resolution approved by the Cabinet of Ministers. The Resolution, in principle, meets donor conditionalities to demonopolize Khlib Ukrainy and to retain only 100 elevators - while not addressing many key issues and leaving Khlib Ukrainy with a significant monopoly over Ukraine's grain sector (i.e., the donor conditionality that Khlib Ukrainy retain only 100 elevators has provided the GOU/the agrarian lobby with ample room to retain control of the grain market; control of Ukraine's 100 largest and most attractive grain elevators represents significant monopoly influence over the market).

The Cabinet of Ministers' Resolution #1218 signed by the Prime Minister on November 6 provides for the following initiatives for demonopolization and privatization of Khlib Ukrainy (KU):

- 100 elevators (17 grain bases and 83 elevators) transfer their assets (not their shares) to KU;
- The remaining 343 KU enterprises are to initiate privatization before mid-1998;

This is the positive news. The negative aspects of the Resolution are:

- The Resolution does not indicate that the 343 enterprises are to be 100% privatized (thus the Cabinet of Ministers can elect to retain up to 26% of the shares of each of these enterprises).
- The 70 elevators holding mobilization reserves are not included in those transferred to KU. At the same time, these 70 are prohibited from privatization. While the GOU seeks to find a mechanism to transfer the reserves to KU, KU may end up controlling these elevators.
- All grain producer outstanding debts to the Ministry of Finance are payable to KU.

The donor community must encourage the GOU to honor the spirit and the letter of its commitments by privatizing 100% of the shares of each of the 343 grain enterprises excluded from the new Khlib Ukrainy.

Draft Energy Sector Privatization Program agreed by the Minister of Energy and the Chairman of the SPF

The Program agreed on November 5 represents a compromise between earlier proposals of the Ministry of Energy and the SPF. It provides for the following key privatization initiatives:

- accelerated sales (with a fixed share sales timetable),
- larger packages for sale on local stock exchanges,
- maximum of 34% for commercial tenders (strategic investors),
- reduction of state shareholdings to 26% in electric distribution enterprises for a maximum of three years
- and 51% in electric generating enterprises for a maximum of five years.
- standard share allocation plans for distributors: 25% for certificates (employees and - what is then unsold - to the public for PPC's), 10%-15% for cash sales via stock exchanges or the PFTS (OTC), 34% for cash sales via commercial tenders (strategic investors), 26% retained by the state for three years.
- for generators: 25% to employees/public, 24% for commercial tenders (strategic investors), 51% retained by state for five years.

First "Energo" Shares Offered in Compensation Certificate Auction

In the 20th CC Auction which begins November 17, the shares of two electric power distribution enterprises will be offered in a CC auction: 3.33% of Kyivoblenergo and 3.00% of Volynoblenergo. We estimate that 4 million CC's might be invested in the CC auction for these shares. A total of 314 enterprises' share packages - the third highest in 1997 - will be offered in the next CC auction.

Please see attached for more detailed progress reports on the MPP team's strategy/policy, strategic sectors, enterprise preparation, UCCA consulting, IT systems support, shareholder registration, and certificate auction audit work during the month of October.

Progress Report

October 1 - October 31, 1997

Key Events/Outputs

- Supreme Rada adopted resolution “On the SPF Report for the period of October 1996 - September 1997” and admitted the work of SPF during the reported period unsatisfactory.
- The Resolution prohibited SPF Acting Chairman and RPF Chairmen to sign purchase/sale agreements, unless the Chairman of SPF is appointed in accordance with rules established by Ukrainian Constitution, which effectively means imposition of moratorium on *cash* (but not certificate) privatization.
- The Resolution extended distribution and circulation of PPCs until June 30, 1998 and December 31, 1998 respectively.
- The Resolution extended distribution and circulation of Housing Checks (HC) until December 31, 1998 and June 30, 1999 respectively and insisted on rapid implementation of procedures for HCs utilization in privatization.
- Assisted SPF in drafting new version of 1998 Privatization Program taking into account comments received from branch ministries. The new draft is to be submitted to the Cab Min.
- Verkhovna Rada cancelled the addenda to CabMin Decree #26/1992 which prohibited privatization of grain industry and some other branches and were invalid de facto. However, Mr. Chernovianov (SPF) considers that this makes all previous privatizations in the branch illegal. PW prepared a legal analysis as to why this decision is invalid.
- Continuously assisted CabMin (the Prime Minister’s and Vice Prime Minister’s advisors) in revising the drafts of CabMin Resolution on demonopolization of Khib Ukrainy: took part in several meetings, including meetings with Khib Ukrainy; prepared for CabMin legal analysis of four drafts; drafted and proposed the version of the Resolution supported by the donors. Provided updates for the donor community on privatization of Khib Ukrainy, Ukragrotekh and Ukragrokhim.
- Upon request from USAID drafted a “Khib Ukrainy Privatization Action Plan”
- Debriefed representatives of the US Department of Agriculture on the status of privatization and demonopolization of Khib Ukrainy and grain market in general.
- Made presentations at seminars in Lviv and Rivne regions for enterprise directors on privatization of Khib Ukrainy enterprises.
- Provided analysis of the two drafts of the Law on Peculiarities of Privatization of Energy Sector in Ukraine. Conducted several meetings with representatives of Schroders (British Know How Fund) to debrief them on the status and legislative background of energy sector privatization.
- Met with World Bank mission to discuss status of fulfilment of EDAL-2 conditionalities prior to negotiations between World Bank and SPF.
- Provided legal analysis of the status of privatization of communal property, which proved that presently SPF have legal authority to conduct sales of communal property.
- Provided counter comments to the SPF’s Valuation Department proposal to change present valuation and enterprise group classification procedures.
- Upon SPF’s request assisted SPF Department of Privatization Infrastructure (Vasina) to draft letter to the CabMin with SPF’s proposal to avoid using Housing Certificates in privatization.
- The joint SPF/PW work plan for October/November 1997 has been finally approved and signed by the parties.

Open Issues

- Procedures for the CabMin approval of share allocation plans of agro enterprises is to be developed and agreed upon.
- Extension of CC distribution and circulation up to the deadlines established for PPCs.
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) to be passed. This issue has acquired special importance since Ukrainian Government have started compensation payments to the persons over 80 years old while Sberbank issued internal instruction not to release payments to those who have collected Compensation Certificates.
- “Plan Graphic” list of companies to be privatized month-by-month through the end of 1997 with 70% depth of sales to be compiled.
- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.
- Development of the simplified procedures for Share Issue Reregistration after share splits at certificate auctions.

PROJECT TEAM:
COMPONENT:

PRIVATIZATION STRATEGY ADVISORY TEAM
PRIVATIZATION DATA ANALYSIS TEAM

Progress Report

October 1 - October 31, 1997

Key Events

- List of enterprises offering share lots for the 34th PPC and 19th CC (November 1997) auctions were published by the SPF.
- The Auction Commission approved the results of the 32st PPC and 17th CC (September 1997) auctions.
- SPF reported 6500 enterprises @ 70%+ and 3250 enterprises @ 100% sold to the World Bank.
- SPF prepared and provided WB with the list of 150 group “D - giant” enterprises (fixed assets >170 mln UAH).
- Parliament approved in first reading new 2500 list of enterprises prohibited for privatization. No major changes were suggested.

Key outputs

- Assisted SPF to verify the information for the 34th PPC and 19th CC auctions.
- Prepared and provided counterparts analytical notes on offered share lots for 34rd PPC, 19rd CC auctions and on 31th PPC and 17th CC auctions results.
- Completed and verified electronic list of additional 224 enterprises planned for privatisation in 1997 by SPF's order #1050 of 09/30/97.
- Using additional information from SPF verified the list of “strategic” and monopolists enterprises.
- Prepared analysis of privatization status of enterprises from “Top 200” list published by Investment Newspaper.
- Started to compile list of “all Ukraine’s elite” enterprises from different ratings published by various sources.
- Updated the auction and certificates distribution statistics on the office network.
- Updated analysis on privatisation status of all AIC enterprises undergoing privatization based on SPF's and UCCA's data as of September 14, 1997.
- Finished analysis and reported to SPF results of regional verification of the status of closed subscription of 694 AIC enterprises.
- Finished compilation and verification of list of all 812 grain-industry enterprises.
- Compiled list of 563 grain-industry enterprises (out of 812) which could correspond to EDAL conditions.
- Prepared analysis on privatization status of these 563 grain enterprises.
- Began to work with SPF and RPFs on verification of 563 enterprise-specific list in order to obtain formal approval of list from SPF.
- At SPF request started to work on software which would allow SPF to monitor group D enterprises SAPs approval status.
- PDAT team continued to provide in-house, full-time, analytical support to several SPF departments.

Progress Report
October 1 - 31, 1997

Key Events

- The SPF issued Order #1180 amending share sales procedures. The new Order calls for the review and approval of share allocation plans of strategically important Group B and C enterprises.
- The Verkhovna Rada approved--and President Kuchma signed—a law abolishing the 1992 Cabinet of Ministers Decree #26, thereby officially authorizing the privatization of grain marketing and distribution enterprises.
- We conducted our regular, monthly EPT general meeting. Representatives from UMREP and the SPF Share Sales Department delivered presentations to EPT regional consultants.

Key Outputs

- EPT consultants assisted USAID and Cabinet of Ministers officials draft a Resolution amending CabMin Resolution #1000 on the demonopolization and privatization of Khib Ukrainy enterprises. This work was done in preparation for the Gore-Kuchma working group meeting, October 22-23.

Auction Preparation

- Assisted RPFs to prepare 117 enterprise information packages of enterprises which had not yet participated in PPC Auctions for the 34th PPC Auction.
- Assisted RPFs to prepare enterprise information packages of enterprises which had not yet participated in CC Auctions for the 20th CC Auction.
- Assisted the SPF in the preparation and dissemination of auction quotas for the upcoming 34th PPC and 20th CC auctions.
- Assisted the SPF and RPF's in prompt delivery and processing the results of the 32nd PPC and 17th CC Auctions.

Enterprise Preparation

- Provided direct technical assistance to 8 new large Group C and D enterprises, bringing the total to 20 large enterprises directly assisted by the EPT.
- Provided inventory and valuation assistance to 4 new Central Apparat enterprises, bringing the total to 24 Central Apparat enterprises directly assisted by the EPT.
- Signed new monthly workplans with SPF counterparts to provide enterprise preparation assistance to agro-industrial complex and non-AIC enterprises.
- Conducted one-day privatization “step-by-step” seminars for 23 Khib Ukrainy enterprises in Rivne and L’viv. Seminars are planned for Chernigiv and Poltava in November. To date, 114 KU enterprises have participated in EPT regional seminars.
- Conducted three regional seminars on shareholder rights, business restructuring, and raising capital. An English-language version of the training manual and a statistical analysis of participant questionnaires was delivered to USAID.

Information Support

- Continued to verify the status of 800 grain industry enterprises subject to privatization.

Open Issues

- The SPF has not fulfilled promises to cooperate on auction planning. We again did not receive the lists of enterprises that should be sold to 70% by December 31, 1997, nor did we receive the SPF's list of Group D Giants.

Progress Report

October 1, 1997 - October 31, 1997

Key Events

- Met with Y. Taratorin to discuss end of USAID financing in 12/97 and actions to be taken; also discussed transfer of related knowledge to UCCA counterpart and formed ACN Training Task Force to determine details of skills to be transferred to UCCA.
- Rada approved PPC distribution to July 30, 1998 and circulation to December 31, 1998.
- Housing checks period of registration extended to December 31, 1998 and circulation to July 30, 1999.

Key Outputs*ACN Consulting/Certificate Auction Support*

- Completed the ACN evaluation for September, 1997. In September, the ACN earned a total of \$160,024. ACN reached 100% of the target only in the category "PPC collection". The least percentage (23%) of the target the ACN reached in the category "CC collection".
- UCCA submitted to PW confirmation of money transfers to the RCCAs according to the PW Instruction Letter for the September ACN evaluation.
- Provided regions with the latest information on the results of the 32 PPC Auction and 17 CC Auction so that RPFs could revise Share Allocation Plans (SAP) and prepare more packages for the upcoming auctions.

ACN Systems Support

- The Satellite Telecommunication System is installed in 8 Regional Centers (Chernivtsy, Donetsk, Kharkiv, Luhansk, Lviv, Odessa, Dnipropetrovsk, Zaporizhyya) and UCCA. Changed network configurations and software switched to windows mode for satellite regions in 4 sites. (Odessa, Donetsk, Dnipropetrovsk, Zaporizhyya). Data transfer speed is increased by 20 - 400 percent.
- According to the regulation two global reports were made in printable and electronic form for UCCA and RCCAs, which give the opportunity to correctly verify the list of certificates than can be used again after enterprise's withdrawal or for bids with errors. 26 regions received new versions of tested software with instructions as well as UCCA received new version of calculation system.
- Preparation of version 2.46 of DEPO system with repair of minor error.
- Update shareholder database reports to improve the speed of the SPF report generation.
- Reinstalled Windows NT on server (it was destroyed) in Odessa RAC.

Monitoring ACN Activity

- Performed review of accounting documentation and internal controls (jointly with UCCA representatives): Volyn and Poltava RCCAs.
- Prepared working papers for UCCA visit and Volyn RCCA.
- Finalized and sent Audit Report of Findings for Sevastopol and Vinnitsa RCCAs.
- Technical review of the following reports: Dnipropetrovsk, Summary BRS, Lugansk.
- RSPF Control Departments were informed regarding the timing of trips to related RCCAs and invited to participate in joint audits of scheduled RCCAs.
- Proposal regarding training seminar and joint audits formally submitted to Ledomska and A. Polishchuk.

- Prepared materials for training seminar for SPF regarding audit procedures and writing of reports.
- Participating in meeting with UCCA representatives regarding the results of the UCCA audit visit and related recommendations.
- Discussed details of seminar and closer working contact with Manager of the UCCA Control Department during RCCA audit visit.

NOVEMBER 1997 PROGRESS REPORT

Mass Privatization and Economic Reform in Ukraine

In recent weeks, negative comments by various officials regarding the certificate privatization program (i.e., the “mass privatization program” - which includes both preferential share sales to employees and certificate auctions) have appeared in the Ukrainian press, radio and television. The most common general criticism is that “certificate privatization has produced no positive results”, i.e. that:

- ◇ “large-scale privatization has not really begun,”
- ◇ “no significant revenues have been generated for the state budget”
- ◇ “effective new owners have not been created”
- ◇ “strategic investors have not appeared”
- ◇ “no financial improvements have appeared at the enterprise level”.

Mass Privatization Objectives versus Cash Sales Objectives

Among many Ukrainian officials and citizens, there is confusion between the objectives of mass privatization (accelerated *political* transformation of the economy) and the objectives of cash sales (*revenue generation* for the national budget and for capital investment in industry). Many officials believe that mass privatization and cash privatization are two separate and contradictory forms of share sales. In fact, they are closely related and are complementary.

Government of Ukraine’s Objectives for Mass Privatization

In 1994, the Vice Prime Minister and the Minister of Economy, on behalf of the government of Ukraine, and officials of the World Bank, the United States Agency for International Development and the European Union, on behalf of the international donors, signed a Memorandum of Understanding to govern Ukraine’s mass privatization program. This set forth the commitments of the government of Ukraine to implement the mass privatization program and the commitments of the international donors to provide technical and financial assistance for the program.

In the Memorandum, the government of Ukraine agreed to the following general objective for the mass privatization program:

“The objective of mass privatization in Ukraine is to (1) distribute shares rapidly and equitably to the citizens of Ukraine, (2) develop capital markets and capital market infrastructure and (3) rapidly create a critical mass of privately owned enterprises to allow necessary restructuring and modernization to proceed under the direction of the new private owners.” (The Memorandum also states that “many other economic factors - external to mass privatization - are critical to the success of the privatization program and privatized enterprises. Progress regarding these factors must occur in parallel to mass privatization.”)

The government of Ukraine’s decision in late 1994 to begin a mass privatization program was based on a realistic assessment of the country’s current situation and on a general vision among Ukraine’s leaders as to the path of reform to be pursued:

- ◇ state-ownership, state management and official corruption had resulted in political mismanagement of the country’s resources and the eventual collapse of the Soviet economy,

- ◇ “privatization” of Ukraine’s industry, as practiced in the early 1990’s (prior to the mass privatization program), had been in the form of “spontaneous” privatization whereby the *nomenklatura* was involved in the widespread theft of state assets,
- ◇ recovery and growth would require radical new initiatives to create an environment which encourages competition, investment and risk-taking by the private sector while discouraging official corruption,
- ◇ and that Ukraine’s future lies in a liberal, market economy with expanding ties to new markets in Europe and other regions of the world.

Ukraine’s reformers also realized that accelerated economic reform and the completion of a mass privatization program would require, more than anything else, a high degree of *political will* on their part. In other words, Ukraine’s leaders would be required to *fight an on-going political battle with those parties most interested in maintaining the status quo* or increasing the role of the state in the economy.

Opposition to mass privatization appeared (and continues to appear) from many different constituencies:

- * state-owned enterprise managers, bureaucrats in the branch ministries, and politicians who did not want to lose their privileges and control over state assets;
- * reactionary politicians who had yet to realize that it would be impossible to “turn back the clock” to a state-owned/command economy;
- * “entrepreneurs” who had reaped huge and illegal profits from their business connections and cooperation with political leaders and state-owned enterprise directors;
- * and older citizens and the most vulnerable segments of the population who realized that they might lose their jobs, that they did not have the skills to compete in a market economy and that the government was unlikely to provide sufficient social welfare benefits to sustain them during the transition to a market economy.

Why “Mass Privatization”?

Based upon the experience of other countries which had earlier initiated the transition to a market economy, Ukraine’s reformers understood that mass privatization offered the only opportunity for rapid, broad-based, in-depth structural reforms of the economy.

With sufficient political will by leaders at the highest levels of the government, Ukraine’s reformers understood that implementation of a mass privatization program could succeed in producing such structural reforms because:

- 1) Mass privatization, with the participation of millions of enterprise employees and the general public, is the most transparent, efficient and rapid means of transferring control rights over the assets and cash flows of Ukraine’s industry from the government to the private sector. *The accelerated transfer of the ownership of Ukraine’s economy from the state to the private sector is the single most important objective (and result) of mass privatization.*
- 2) The basic assumption behind this objective is that government/political ownership of industry results in unproductive, uneconomical, non-market oriented, corrupt, and “political” management of industry - and ultimately to industrial mismanagement and industrial decline. *Mass privatization is the single most rapid and efficient means of “depoliticizing” ownership of the economy.* There is nothing more important to the success of Ukraine’s reforms.

- 3) *As government ownership and management of industry disappears, new, private sector investors - who are willing to accept the risk of losing their capital in exchange for potential returns, are encouraged to become enterprise owners.* Not only do such new owners invest their capital, they work hard to ensure a maximum return on their investment. And a maximum return requires that these new owners replace existing, often incompetent (and often corrupt) directors, restructure production by expanding those most profitable and promising business lines while discontinuing unprofitable business lines, develop new marketing strategies and new markets for their products, retrain employees, and create enterprises better able to compete in both the domestic and international markets.
- 4) With ownership transfer from the state to the private sector and with new owners and managers of formerly state-owned enterprises, *conditions are created for the government to play a new role in the economy:* not as an owner of industry but as a regulator to promote an optimal environment for the development and growth of the private sector, for the promotion of entrepreneurship by the public, for the rule of law over property rights and business contracts, for the encouragement of investment through a reduction in both bureaucratic interference with business and onerous taxation, and for *the creation of a general climate in which government promotes rather than discourages the private sector.*
- 5) *Workers, managers, the public and financial investors will actively respond to economic incentives and opportunities - as provided through the mass privatization program - to become shareholders* in their own enterprises, in attractive enterprises with which they are familiar and in enterprises which they believe might best prosper in a market economy.
- 6) Mass privatization (preferential share sales to employees and certificate auctions) of the shares of Ukraine's largest and most attractive enterprises is the most effective, rapid and transparent means by which privatization of such enterprises is initiated and by which employees and managers (and the public) become long-term investors in and supporters of the privatization and restructuring of their own enterprises. *Mass privatization is the first stage in the privatization of large, attractive enterprises and provides a base of employee and broad, public shareholder support for major new shareholders and owners - i.e., financial investors who purchase shares in cash auctions and strategic investors who acquire majority shareholdings through cash/investment tenders.* Thus, mass privatization is not incompatible with cash sales and tenders but, in fact, serves as the basis for successful future cash sales and the attraction of new capital investment by strategic investors.
- 7) Mass privatization is one of the most transparent, competitive and accelerated forms of privatization with shares sold on an objective basis to bidders offering the highest number of certificates. The process of selling shares through the mass privatization program is therefore the ideal model for sales of shares for cash and via tenders for strategic investors. Transparent and competitive procedures for cash sales and investment tenders are an effective means of attracting domestic and international financial and strategic investors to Ukraine's privatization program. *It is therefore critical that Ukraine's sales of remaining large or majority share packages in its strategic enterprises employ the transparency and the non-subjective, competitive and accelerated aspects of the mass privatization program* (while avoiding non-transparent, uncompetitive and time-consuming forms of privatization such as non-commercial tenders and case-by-case/negotiated share sales).
- 8) *The final major reason behind the government of Ukraine's decision to implement the mass privatization program in early 1995 was the understanding by government reformers that*

the rapid and broad distribution of shares to millions of new shareholders quickly creates improving conditions for:

- the development of a large and active secondary securities market for the trading of shares in privatized (as well as newly established, privately owned) enterprises,
- the acquisition of large shareholdings in Ukraine's promising privatized enterprises by strategic and financial investors who exercise their shareholder voting rights to initiate changes in management, production, marketing programs, training and utilization of employees, and other strategies which will generate long-term, sustainable growth and profitability for such enterprises in a competitive, market economy,
- the liquidation of uncompetitive, unpromising and bankrupt enterprises and the redeployment of their assets to more productive and profitable uses,
- the ability of promising enterprises - which have been restructured by their new, private sector owners - to pay wages and benefits to their employees, to pay their electric bills, to pay taxes and, in general, to serve as financial contributors to their workers, their communities and the government,
- and the ability of the government, with increased tax revenues from expanding and profitable enterprises and with reductions in state subsidies to industry, to utilize scarce state budget revenues to support the most vulnerable segments of society: workers who are temporarily unemployed as a result of the bankruptcy and liquidation of enterprises, pensioners, and those who are unable to care for themselves.

In practice of course, privatization is always a "messy," complicated and very political process. The benefits of enterprise restructuring and the inflow of new investment capital do not occur immediately after privatization. The tangible benefits of privatization depend to a great extent upon the speed by which mass privatization is completed and remaining state shareholdings are sold to private sector investors. At the same time, experience proves that - if the leadership of Ukraine focuses on rapidly accomplishing the objectives of mass privatization, new investment, enterprise restructuring, and the revival and growth of Ukraine's economy will follow.

Ukraine's Mass Privatization Program: Results

The government of Ukraine, the State Property Fund and the citizens of Ukraine should be congratulated for the success of the mass privatization program to date and the accomplishment of many of the objectives listed above. And the public should be encouraged to continue to become shareholders through a program which will, over the coming months, provide Ukraine with opportunities to attract substantial new capital investment in its attractive enterprises, to begin the necessary process of enterprise restructuring, to promote an environment in which new businesses - large and small - can prosper, and to generate economic growth.

Ukraine's mass privatization program to date has faced numerous challenges and obstacles and has had to overcome many politically-inspired delays. The public, employees, individual enterprises and the economy have not yet seen many tangible benefits from the progress of the past nearly three years.

However, the results are impressive and are the basis for tangible economic benefits for Ukraine in the months ahead:

- * Nearly 7000 medium/large enterprises privatized since the beginning of the mass privatization program in January 1995.
 - * 40% of the shares of these 7000 enterprises were sold to employees and the public for certificates.
 - * 5700 enterprises have sold shares in Privatization Property Certificate (PPC) auctions and 3500 enterprises have sold shares in Compensation Certificate (CC) auctions.
 - * Approximately UAH 18 billion (nominal value) of shares have been transferred from state to private (the public) ownership by enterprises which have participated in PPC auctions.
 - * 46 million citizens have collected their PPC's. 37 million PPC's have been invested.
 - * 25% of available CC's have been collected by the public.
 - * A (conservatively) estimated 15 million individual Ukrainian citizens have become shareholders through certificate auctions.
 - * More than 4200 agro-industrial enterprises have begun share sales to employees and suppliers.
 - * Most of Ukraine's largest, most attractive and "giant" enterprises have begun share sales to employees and the public through the mass privatization program, to be followed by share sales for cash and in tenders for strategic investors.
 - * Ukraine's strategic industrial sectors - including electric power, telecommunications and air transportation - have already begun privatization (beginning with share sales to employees and the public through the mass privatization program) or are developing plans for restructuring and privatization.
 - * As a result of the privatization of thousands of enterprises, the creation of millions of new shareholders and the distribution and sale of millions of new shares, a growing and active secondary (and primary) securities market has developed involving a major over-the-counter trading system and several stock exchanges and the establishment of both the full range of securities market participants (brokers, investment funds, investment management and research firms, share registrars, depositories, custodians) and a securities market regulator with the legal powers to ensure that the market operates transparently and that the rights of shareholders are protected.
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It may be difficult to convince the public, employees, enterprise managers and politicians that these results of privatization are "positive" and that they will eventually produce an economic turnaround and material benefits for the public. However, the public is certainly intelligent enough to understand that this first phase of reform, however painful, is the only alternative to stagnation and decline of Ukraine's economy. It is a phase that they would like to see completed as quickly as possible as they await Ukraine's economic turnaround and growth beginning in 1998.

Progress Report

November 1 - 30, 1997

Key Events/Outputs

- Presidential Decree on conducting international cash tenders has been issued, providing possibility to sell shares to strategic investors through relatively (compared to standard tender regulation) more streamlined and transparent procedures. Decree will come into force in one month if not rejected by the parliament within this period. Appropriate tender regulation has been drafted by the SPF to be approved after Decree becomes effective.
- President has conducted special meeting dedicated to the present state of privatization in Ukraine where he expressed his full support to SPF Acting Chairman Lanoviy, and necessity to complete certificate privatization as soon as possible though no specific decisions to accelerate the process have been taken.
- Cabinet of Ministers reviewed the status of privatization of energy generating companies at its session and decided to consider possibility of limiting sales of shares to one buyer to 10% and to introduce “golden share” concept.
- The GOU considers possibility to launch so called “loan-for-shares” scheme driven by the necessity to cover state budget deficit. Though no specific decision has been taken so far, many discussions of the new approaches to privatization have been discussed.
- CabMin has finally approved the Resolution #1218 on privatization of grain enterprises and demonopolization of Khib Ukrainy (KU). SPF received it but the Resolution has not been officially published and hence has not come into force yet. There are still several unresolved issues which do not permit implementation, such as the requirement to transfer to KU the property of enterprises being privatized. PW prepared and submitted to SPF, RPFs and KU enterprises legal analysis and comments on this issue in order to ensure that those enterprises which have initiated privatization process will not be required to return to KU ownership.
- Upon request from SPF, PW prepared legal analysis proving that Decree #26 which prohibited privatization of grain industry is invalid following approval of the new Privatization Law.
- Assisted World Bank EDAL Appraisal Mission and the SPF to conduct negotiations on EDAL II conditionalities.
- Assisted the SPF in drafting 1998 Privatization Program, which is now being considered by the SPF acting Chairman.
- Provided Mr Grigorenko (privatization advisor to the Prime Minister) with the set of analytical materials related to the present status and strategic issues of privatization.
- The new organizational structure of the SPF has been approved by Lanoviy. According to the new structure all departments responsible for strategic sales have been subordinated to the SPF acting Chairman.
- Conducted series of meetings with officials from Cab Min, Ministry of Finance, Transport Ministry to discuss the status of privatization of strategic enterprises in the energy, telecommunications and aviation sectors.
- Conducted presentation promoting Mass Privatization in Ukraine at the International Conference held by Ukrainian Institute of International Relations.
- Prepared an analysis of the Law on Telecommunications and the draft laws on peculiarities of privatization of energy and aviation sectors for the SPF and the Cab Min.
- Prepared an analysis of the status of the Joint SPF/PW Work Plan for October - November, 1997 for the SPF.

- Conducted a series of meetings with Mr Gordienko, president of PARD, to discuss PW MPP future assistance and joint work.

Open Issues

- Amendments to Cab Min resolution on “Khib Ukrainy” should be changed to exclude from Khib Ukrainy grain elevators which are already being privatized.
- Expediency of the loan-for-shares scheme and its legitimacy under the present privatization legislation.
- Procedures for the Cab Min approval of share allocation plans of agro enterprises is to be agreed upon.
- Extension of CC and PPC distribution and circulation (PPC extension is not valid as Rada resolution which extended PPC has not been published since adoption).
- The amendment to the Law on Compensation for Lost Savings allowing people to collect their CCs (without forfeiting other forms of compensation) is to be passed by the Rada.
- Cancellation of the Share Issue Registration State Duty for enterprises to be privatized.
- Development of the simplified procedures for Share Issue Reregistration after share splits at certificate auctions.

PROJECT TEAM:
COMPONENT:

PRIVATIZATION STRATEGY ADVISORY TEAM
PRIVATIZATION DATA ANALYSIS TEAM

Progress Report

November 1 - 30, 1997

Key Events

- Lists of enterprises offering share lots for the 35th PPC and 20th CC (December 1997) auctions were published by the SPF.
- The Auction Commission approved the results of the 31st, 33^d PPC and 18th CC (December 1997) auctions.

Key outputs

- Assisted SPF to verify the information for the 35th PPC and 20th CC auctions.
- Prepared and provided counterparts with analytical notes on offered share lots for 35rd PPC, 20th CC auctions and on 33^h PPC and 18th CC auctions results.
- Working with SPF, started to compile list of 950 enterprises to begin privatization in 1998.
- Started to work with SPF on verification of 100 enterprises to be added to the list of “strategic” enterprises.
- Started to work on analysis of regional breakdown of “Top 200” largest enterprises.
- Completed database of monopoly enterprises.
- Started to work with recently established Restructuring and Pre-privatisation Support Department of the SPF on collection and compilation of data related to “strategic” industries privatization.
- Continued to compile list of “Ukraine’s elite” enterprises using monopoly enterprises database.
- Updated the auction and certificates distribution statistics.
- Updated and provided SPF with analysis on privatisation status of all AIC enterprises undergoing privatisation based on SPF’s and UCCA’s data.
- Finished compilation and verification of responses of regional SPF offices on status of privatization of grain industry enterprises.
- Reported to SPF discrepancies between actual privatization status of grain industry and ETAP information.
- Provided SPF with the list of 563 grain-industry enterprises subject to the World Bank’s EDAL II conditionalities.
- Finished database creation and stated to enter data on group D enterprises’ Share Allocation Plans’ approval status. Program has been installed in DSSS Department of the SPF.
- Team members conducted several training seminars for DSSS and AIC Departments of the SPF on EXCEL and ACCESS software.
- Team continued to provide in-house, full-time, analytical support to several SPF departments.

Progress Report

November 1 - 30, 1997

Key Events

- The Cabinet of Ministers (CabMin) passed on November 5 Resolution #1218 restructuring Khlib Ukrainy (KU). The list of enterprises—but not the text itself—was subsequently revised and the SPF approved the revised Resolution on November 19. According to the Resolution, 343 KU enterprises are to be privatized, including 100 by the end of 1997. PW statistics indicate that 443 KU enterprises can be privatized, but that it is unrealistic to expect that 100 can reach 70% sold.
- On November 25, the SPF issued an internal order reorganizing the major departments of the Central Apparatus. According to the new organization, Ledomska is responsible only for certificate auctions and AIC privatization. Filozop will continue to handle enterprise preparation issues and Sai will be responsible for pre-privatization enterprise restructuring in a new department subordinated to Vasiliev.
- Utility companies (“energос”) began to participate in certificate auctions for the first time. In the 20th CC auction, 2 oblenergo companies sold shares for certificates, while 5 oblenergos participated in the 35th PPC auction.
- The Board of Directors and EP regional managers met on November 7-8 to discuss MPP strategy and staffing issues. In addition, performance evaluations were completed for all EP staff.

Key Outputs*Auction Preparation*

- Assisted RPFs to prepare 110 new enterprise information packages for the 35th PPC auction, including 5 oblenergo companies.
- Assisted RPFs to prepare enterprise information packages to meet the quota of 300 enterprises in the 21st CC auction.

Enterprise Preparation

- Drafted a report on resources, results and recommendations and delivered it to USAID; copies were delivered in Ukrainian to the SPF.
- Prepared new, simplified procedures for securing Cab Min agreement on the share allocation plans of AIC enterprises.
- Provided direct technical assistance to 20 large Group C and D enterprises.
- Assisted select Central Apparatus enterprises with inventory and valuation issues, including Khmelnytsky and Ternopil radio factories and the Mukacheve (Zakarpatska oblast) brick company, all of which EPT Kyiv-based consultants visited in November.
- Organized a KU seminar in Poltava on November 21. Twenty-seven KU enterprises (over one hundred people) attended. A new training manual was designed and distributed to participants. Subjects included "KU privatization step-by-step," shareholder rights, inventory and valuation. To date, 141 KU enterprises have participated in EPT regional seminars.
- Visited, together with SPF officials, a collective farm in Cherkaska oblast on November 22 to organize and conduct a general meeting on the free transfer of shares to individuals. A meeting on this issue was also held in Chernigiv November 28 with farm directors, local officials and representatives from IFC and the SPF.

Information Support

- Completed verification of the status of 800 grain industry enterprises subject to privatization.

- Completed verification and analysis of 343 enterprises allegedly excluded from the privatization process.

Open Issues

- 50 Khlib Ukrainy enterprises that have started privatization were included in the List of 100 enterprises that must transfer their property to JSC “Khlib Ukrainy.” How and whether they will do so are open issues.

Progress Report

November 1 - 30, 1997

Key Events

- The National Bank continues to require from the RCCAs payments for certificate storage. Required payments vary between 0.5 hrivna and 0.25 hrivna per certificate.
- SPF has not approved the documents on ACN restructuring.
- The MOU on the cooperation between PW and UCCA in 1998 was drafted.
- Met with the SPF's IT department to discuss training in auction software for the SPF staff in order to transfer PW skills and knowledge.

Key Outputs*ACN Consulting/Certificate Auction Support*

- Completed the ACN evaluation for October 1997. In October, the ACN earned a total of \$166,540. ACN reached 100% of the target only in the category "PPC collection". The percentage of CC collection grew from 23% in September to 34% in November.
- UCCA submitted to PW confirmation of money transfers to the RCCAs according to the PW Instruction Letter for the October ACN evaluation.
- Provided regions with the latest information on the results of the 33rd PPC Auction and 18th CC Auction so that RPFs could revise Share Allocation Plans (SAP) and prepare more packages for the upcoming auctions.
- Drafted the MOU on the cooperation between PW and UCCA.

ACN Systems Support

- New components for telecom system were tested and prepared for sending and processing data with higher speed and were given to the UCCA for distribution. Software is in use by both UCCA and RCCAs.
- The process of organization and installation of dedicated line between UCCA and Infocom was started.
- Continued routine maintenance and user guidance for the various live systems including compensation certificate and PPC bid collection and auction processing systems.
- Made changes to auction processing system reports at UCCA's request.
- Delivered new version of financial intermediaries' data processing software .
- Prepared and tested the software for importing data of sales for leftovers in privatisation accounts into Shareholders database.
- Modified the Shareholders database reports connected with the output list of shareholders. The speed of creation of all reports was improved.
- Met with Mr. Sinenko, Head of SPF IT Department to give him official memorandum on software training and future software transfer to SPF. Developed plan and started preparations for SPF staff training seminars.
- All office databases (including developed DBs) were moved to the new server LN 4.5.2.
- Continued user support for LN 4.5.2. version.

Monitoring ACN Activity

- Performed review of accounting documentation and internal controls (jointly with UCCA representatives): Sumy and Donetsk RCCAs (SPF/RPF individuals invited and encouraged to participate).
- Prepared working papers for Poltava, Sumy and Donetsk RCCA audit visits.
- Finalized and sent Audit Report of Findings for Lugansk and Dnipropetrovsk RCCAs and seven permanent BRSs.
- Technical review of the following reports: Volyn and Poltava RCCAs.
- Proposal regarding training seminar and joint audits formally submitted to Svetlana Ledomska and subsequently to S. Babich at the SPF.
- Finalized audit training manual (including reporting section) for seminar for SPF/UCCA.
- Coordinated with UCCA regarding list of participants submitted for the training seminar.
- Began drafting post CC audit procedures for discussion internally with PW Policy team.

Problems identified, open issues requiring decision

- Decision on the procedure of USAID property disposition needs to be made.
- The SPF is not currently ready to assign professionals for software and audit training (for transfer of these functions from PW MPP team to the SPF - to be completed by March 1998), it means further delays in initiating training.

DECEMBER 1997 PROGRESS REPORT

I. Key Mass Privatization Events

Government Proposes to End Certificate Auctions in Mid-1998

Many officials in the government of Ukraine have proposed that certificate auctions not be continued in 1998. The government's proposed *1998 Privatization Program* requires that the last certificate auctions be held in the month of June 1998. The government's *Program* also discontinues the distribution of Privatization Certificates (PPC's) and Compensation Certificates (CC's) in 1998.

The end of certificate auctions by the middle of 1998 will create the following problems for Ukraine's privatization program:

- Thousands of medium/large enterprises will be unable to reach 70% or more shares sold. (These are enterprises which are unable to sell shares for cash because they are not attractive to investors. Thus, these enterprises would only be able to sell shares - quickly - through CC auctions.)
- The State Property Fund and the government will thus be unable to reach their privatization targets for medium/large enterprises.
- Many "giant" enterprises (and other attractive enterprises) will have not yet offered shares in PPC auctions.
- The public and financial intermediaries will lose the opportunity to invest their PPC's and CC's, particularly in attractive enterprises.

Record Number of Certificates Invested in December CC and PPC Auctions

While the government proposes to end certificate auctions, the public and financial investors are actively seeking opportunities to invest their certificates, especially in attractive enterprises:

- 4,600,000 CC's were invested in the 20th CC auction (which ended in mid-December). This is the highest number for all CC auctions to date, representing 30% of all CC's invested in 1997.
- Out of the total CC's invested in the 20th CC auction, 3,500,000 CC's (76%) were invested in three attractive enterprises, Kyivoblenergo, Volynoblenergo and JSC Rosava tire plant.
- 1,430,000 PPC's were invested in the December PPC auction. This is one of the highest numbers for all PPC auctions to date. Seven giant, attractive enterprises (six oblenergos and the Luhansk Locomotive Plant) were responsible for creating this strong interest by investors.

SPF's Future Auction Plans

An estimate 45 million CC's have been collected by the public - but have not yet been invested. The public and financial investors still have great interest in investing their PPC's and CC's, especially in attractive enterprises.

Despite the large number of uninvested CC's and investor interest in attractive enterprises, early 1998 CC and PPC auctions - as approved by the SPF - will not attract significant investor interest. And these auctions will not accelerate Ukraine's privatization program.

The State Property Fund approved orders for the 22nd (beginning mid-January 1998) Compensation Certificate auction. *This will be one of the worst in the history of CC auctions:*

- only 43 participating enterprises will reach the 70% shares sold level,
- of these, only 31 Group B, C and D enterprises will reach 70% sold,
- only 214 enterprise share packages are being offered,

- 110 of these enterprises are participating for the second time in a CC auction,
- no large, Group D enterprises are participating,
- and only 4 SPF Central Office enterprises are participating.

The SPF also approved orders for the 37th (February 1998) Privatization Certificate auction. *This will be the worst in the history of PPC auctions in terms of the number of new enterprises and the value of share packages being offered:*

- only 83 new enterprises will participate including only 4 giant enterprises.

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- The SPF draft *1998 Privatization Program*, after consideration by the Cabinet of Ministers (CoM), was amended by eliminating certificate sales quotas and by changing the sequence of sales (sales for certificates were proposed to be conducted after cash sales). The amended draft has been submitted to the Presidential Administration to be issued in the form of a Presidential Decree.
 - Verkhovna Rada (VR) Deputy Ugarov prepared a separate version of the Program based on the provisions of the *1997 Privatization Program* but without certificates quotas. This draft was considered by the VR but their decision was postponed until January 13, 1998.
 - The VR discussed and approved in the third reading the *Law on the List of State-owned Enterprises Prohibited From Privatization*. The list itself was not yet approved.
 - The Presidential Decree on international tenders was rejected by the VR. The SPF drafted and submitted to the Ministry of Justice for registration a new set of procedures for tenders and advisor selection, leaving the main principles of the rejected decree unchanged, but substituting the definition of “international tender” by “open sales”.
 - The SPF announced a tender for an advisor for the planned international tender of Donbasenergo. Three bids were submitted, but none were opened by the Tender Commission within the previously announced terms. (According to the SPF, the opening is to take place on January 10.)
 - Compensation Certificate (CC) distribution and circulation terms expired. The draft CoM resolution extending CCs, submitted by the SPF to the Prime Minister, was not signed. In early January 1998, Sberbank stopped distributing CCs, while auctions continued since the *1997 Privatization Program*, which legitimizes CC auctions, will be valid until the *1998 Program* is adopted.
 - The SPF began drafting the *Law on Privatization of the Strategic Enterprises*. Two meetings of the “Inter-ministerial Commission” created by CoM for the drafting of the Law were conducted with PW participation at the SPF.
 - Khib Ukrainy (KU) submitted to the CoM and the SPF draft changes to CoM Resolution #1218. According to the draft, 21 enterprises are to be taken out from KU, 15 - added back, while 14 enterprises must transfer 26% of their shares to KU.
 - The CoM approved privatization plans for 48 Khib Ukrainy enterprises. The SPF plans to prepare an additional 52 privatization plans to meet the Gore-Kuchma target of 100 (KU share allocation plans to be approved in 1997).
 - The *Law on Value Added Tax (VAT)*, which came into force in October 1997, stipulates that property sales only for Privatization Property Certificates (PPCs) and CCs are exempted from VAT. This means that SPF should pay VAT on all cash sales from October 1997 onward, and will increase the selling price by 20% and require significant amounts of cash. With the start of tenders for Ukraine’s largest enterprises, this new Law may (negatively) impact the privatization process.
 - Lists of enterprises offering share lots for the 36th PPC and 21st CC auctions (December/January 1998) were published by the SPF.

- The Auction Commission approved the results of the 34th PPC and 19th CC auctions (October/November 1997).
- Five oblenergos were announced for participation in the 36th PPC auction; PW assisted in the preparation of one of them (Luganskoblenergo).
- The joint PW/SPF Agro-Industrial Complex Work Plan for December-January was signed.
- The Memorandum of Understanding (MoU) on cooperation between PW, the UCCA, and the SPF in 1998 was signed by PW and the UCCA. (SPF signature is expected shortly.)
- IT training for SPF staff on auction centers software maintenance began.

II. Project Management Report

We appreciate the current focus of the SPF/CoM/Government of Ukraine (GOU) on cash tenders and revenue generation for the budget. At the same time, mass privatization/certificate auctions remain critical to the completion of Ukraine's privatization program in 1998/99. We believe that the recent opposition of the Prime Minister to continuation of certificate privatization is thus ill-advised. In addition, we believe that mass privatization experience can be better utilized by the SPF to provide the principles and procedural framework for the SPF in its transitioning to cash sales.

The most efficient, successful and transparent aspect of Ukraine's privatization program since the country's independence is the system (the policies, procedures, software, operating procedures, "how to" manuals, enterprise preparation, pre- and post-auction analyses, system integrity safeguards and audits, counterpart training, public information, et al) developed and implemented by the PW Mass Privatization Project (MPP) team beginning in late 1994 and responsible for the privatization of several thousand medium and large enterprises. This experience could be utilized by the SPF/GOU to develop and implement an efficient, successful and transparent system for conducting cash sales.

With the exception of the offering of small packages of leftover, state shares in hundreds of enterprises on stock markets and through the Auction Center Network, no more than 2% of Ukraine's medium/large enterprises can eventually expect to be sold via cash/investment tenders for large share packages/majority interests). Thus, certificate auctions - despite the opposition of the Prime Minister and other officials in the GOU - are key to completion of the first phase of Ukraine's economic reform. The current de-emphasis on rapid completion (*"completion" means offering the shares of all approximately 11,000 eligible enterprises in certificate auctions*) of certificate auctions/mass privatization - including the halting of Compensation Certificate distribution to the public - means further delay in ever completing the process of ownership transfer from the state to the private sector.

The SPF/GOU will have the benefit of our experience and broad deployment of consultants - to both complete certificate auctions and to help establish the mechanisms and procedures for transitioning to effective and transparent cash sales - for only a few more months. It is therefore important that USAID and the leadership of the PW team jointly meet with Mr. Lanoviy and his deputies shortly to agree on the type of urgent technical assistance to be provided by the PW team during this final phase of our task order. What help does the SPF most want/need now versus what help can we actually provide? And, once this is agreed, what help will the SPF actually allow us to provide?

Mr. Lanoviy's assistant has indicated that the SPF Chairman will sign the SPF/PW Memorandum of Understanding regarding GOU assumption of Auction Center Network financing beginning this month and the provision by the PW team of technical assistance to the network through the end of the task order. This is positive news. However, beyond the Auction Center Network, the SPF requires significant assistance over the next few months to prepare for the completion of certificate

auctions and to improve the transition to/process of other forms of share sales. Thus, a “final phase” technical assistance strategy meeting with Mr. Lanoviy and his deputies is necessary.

Current Issues

Commercial Tenders for Strategic Enterprises

While much attention is being paid to proposals of the SPF/GOU to hire underwriters to conduct international share sales for Donbasenergo and other “strategic” enterprises, *plans for cash sales of giant/strategic enterprises - via commercial tenders - are well underway.*

Commercial tenders for large share packages of 15 giant enterprises including 9 regional electric distribution companies were officially launched by the SPF on December 23 with the formal announcement in the *Investment Gazette* of tenders for 20% to 25% each in seven regional power companies.

Thus, while plans for new forms of international tenders are being debated, the SPF is rapidly proceeding with the offering of large share packages in strategic enterprises. The commercial tender for the first seven oblenergos is to be concluded within one month of the formal announcement, i.e. before the end of January 1998. And while the existing commercial tender regulations are far from ideal, they are at least a usable and legally established basis for both generating budget revenues and for attracting strategic investors.

Our analysis indicates however that the commercial tenders for the large share packages in seven regional power companies to be sold before the end of this month are however unlikely to be successful given the tender terms established by the SPF, i.e.

- While called “commercial” (cash) tenders, they are in actuality investment tenders since the investment commitments are several times greater than the minimum required up-front cash payments. (The seven tenders are classified as commercial tenders because the investment commitment for each is fixed while the competition involves the cash/up-front payment.)
- The starting/minimum cash prices are generally close to or in excess of the current market (OTC) price for the shares.
- The all-in cash + investment commitment is, for each of the seven power companies, about two to six times the current market price of the shares.
- While the potential investor must commit to fixed investments in each enterprise, the investor receives less than a “blocking” or controlling share package - and thus technically has no say in the enterprise’s future investment plans and strategies (and thus no say as to whether such plans make economic sense).
- Bidders have only 30 days in which to complete due diligence. This is insufficient time in which to ascertain, for example, whether near term debt repayment and working capital requirements are realistic and whether longer term investment commitments in equipment, environmental protection and social assets are justified.
- In other words, bidders are expected to bid as though they are strategic investors while (with 20% of the shares) they are given the rights of portfolio investors.
- While these commercial tenders have been announced in the Ukrainian press, no formal announcements have been published in the international press. Thus, with the exception of a handful of international investors who are aware of/involved in the local market, most potential international investors remain unaware of the tenders. *As these are large share packages in Ukraine’s few giant/strategic enterprises, this lack of international publicity is incomprehensible.* Is it realistic to expect that domestic investors will commit more than the equivalent of \$130 million for minority stakes in seven regional energy companies?

- Given these conditions, it is likely that these seven commercial tenders will attract no bids at the minimum terms and that the SPF will be required to conduct one or two more rounds of bidding (with a reduction of 30% in the cash starting price each time) in order to complete the sales - which means completion of sales by next summer at the earliest.
- In addition to the seven regional power companies, the SPF will announce within the next few weeks details of the commercial tender terms for at least 15 more regional electric distribution companies and commercial (and non-commercial) tenders for 19 additional giant, strategic enterprises.

1998 Compensation Certificate Distribution and Auctions

Mr. Lanoviy has signed the Order for the 22nd (1/15/98 - 2/14/98) Compensation Certificate auction, thereby confirming the SPF's intention to continue holding CC auctions despite the uncertainty regarding GOU (and Verkhovna Rada) support for doing so. 214 enterprise share packages have been prepared to date for this auction.

While the Rada has by resolution extended Privatization Certificate distribution/auctions through mid/end 1998, neither the Cabinet of Ministers nor the Rada have issued resolutions regarding continued CC distribution and auction. The legal basis for continuing to conduct CC auctions in 1998 is the 1997 Privatization Program (i.e. until the 1998 Privatization Program is adopted, the terms of the 1997 Program apply).

Both the SPF and the Rada privatization committee's draft 1998 Programs call for continuation of CC auctions in 1998 - but do not extend CC distribution beyond the end of 1997. It appears that only by persuading the Prime Minister to modify his opposition to certificate auctions will CC distribution be extended into 1998.

January 1998 Privatization Property Certificate Auction

While very concerned about the situation regarding CC auctions, our analysis of the enterprises/share packages on offer in January's Privatization Property Certificate auction indicates that it will generate relatively successful results. In general, the auction is acceptable in terms of the quantity and quality of share packages being offered and is in line with 1997 averages, i.e.

- 133 new enterprises and 344 enterprises in total are offering shares,
- 15 "Group D" enterprises are participating (12 for the first time) - a figure twice the average in Privatization Certificate auctions to date,
- 6 regional electric utilities - all classified as "giant" enterprises - are offering from 4% to 6.8% of shares to the public,
- 9 "strategic" (as classified by the Cabinet of Ministers) are participating in the auction.

Other Critical Issues

As we begin a new year - the year in which the GOU and the Rada intend to successfully complete Ukraine's Mass Privatization program, there are a number of other critical and potentially negative developments which will face the USAID/PW mass privatization project team over the coming weeks.

Depending upon the willingness and ability of the SPF/GOU (and in some cases the Rada) to address these issues, the certificate auction program, the transparent transition to cash sales of strategic enterprises, generation of privatization proceeds for the state budget and for investment in strategic enterprises, attraction of foreign portfolio and direct investment, and the securing of new World Bank and IMF credits could be negatively impacted:

- Extension of Compensation Certificate distribution to at least mid-1998 and CC auctions until end-1998 (as the most effective means for fully privatizing all eligible enterprises and for completing the sale of all remaining state shareholdings);
- More effective certificate auction planning for 1998: The offering of all approved new enterprise share packages (150 to 200 enterprises per month) in PPC auctions; the offering of all remaining state shares (except in strategic enterprises) in eligible enterprises (400 per month) in CC auctions; the completion of the privatization - through preferential share sales - of 150 agro-industrial enterprises each month.
- The retention of key aspects of the *1997 Privatization Program* in the *1998 Program* including: An established sequence of share sales (i.e. sales to employees and to the public for certificates first - which is the key to initiation of enterprise privatization, followed by cash sales, with all unsold shares offered in CC auctions); minimum certificate auction share allocation quotas for all enterprises (which is the key to both initiation of the privatization of - and the prevention of retention by the state of large shareholdings in - all enterprises, particularly the largest, most strategic enterprises).
- A rapid and clear decision by the Prime Minister is required to resolve the on-going, months-long debate within the CoM (and between the management of KU/the Agro-Industrial Ministry and the SPF/Vice Prime Minister Tyhypko) regarding the KU monopoly. The CoM adopted a resolution last fall to de-monopolize and privatize this grain storage/distribution monopoly. However, the GOU has yet to decide what grain elevators/enterprises will remain in KU, has yet to confirm that those former KU enterprises which have begun the privatization process cannot - legally - be reincorporated into the monopoly, and has yet to confirm that KU will not be allowed to retain shareholdings in ex-KU enterprises.

Transparency

The successful completion of PW's final USAID Mass Privatization Project Task Order is highly dependent on the ability of USAID and the international donor community and their consultants to not only secure general agreement on privatization-related financial assistance conditionalities - but to receive tangible evidence of the GOU's (Presidential Administration, CoM, SPF) willingness to accelerate and transparently complete the privatization program.

What might the SPF/Cabinet of Ministers/GOU do (encouraged by the international donor community) - on both a "macro" and "micro" level - to ensure the successful completion of the Mass Privatization Program and the accelerated and transparent transition to the sale of controlling interests in strategic enterprises to international investors?

- 1) Our experience over the past three and one-half years indicates that the *single most important issue* facing the GOU and the international donors - and one which is critical to the successful completion of the Mass Privatization Program, to the successful transition to international share sales via cash/investment tenders for share packages in strategic enterprises, and to the overall success of Ukraine's privatization program (and to Ukraine's success in nurturing the development of entrepreneurship and private enterprise, to the government's success in eliminating official and unofficial corruption, to the attraction of foreign direct and portfolio investment, to the repatriation to Ukraine of billions of dollars of capital which has been illegally transferred offshore over the past decade and to the general recovery of an economy whose deterioration is among the most alarming of post-war Europe) - *is the issue of transparency.*
- 2) *While lack of transparency permeates all aspects of official life in Ukraine, we are particularly concerned with those aspects which impede the accelerated completion of*

Ukraine's privatization program and the accomplishment by the PW MPP team of its task order deliverables:

- * *Lack of disclosure of essential data (which is legally required to be in the public domain) by the SPF to the PW MPP team, to the donor community and to the public including up-to-date information on the overall status of privatization/share sales of all medium/large enterprises which are in the privatization universe, on the individual preparation and share sales status of each enterprise which has initiated the privatization process, on the number of enterprises for which new share packages can be offered in forthcoming PPC auctions, on the number of enterprises for which remaining shares can be offered in forthcoming CC auctions, on the status of share allocation plans approved by the SPF and the Cabinet of Ministers, and on numerous other specific types of privatization data.*

- * *This lack of disclosure of essential data by the SPF to the PW MPP team requires that we continue to secure data "unofficially" from SPF officials who are willing, on a "no name", confidential basis, to provide limited data. Such paranoia, secrecy and non-transparency regarding data which is supposed to be in the public domain creates obstacles for all of our task order projects: strategy consulting, policy consulting, privatization data analysis, enterprise preparation, PPC and CC auction planning, and MPP audit.*

- * *Lack of disclosure of essential data not only impedes the work of the PW MPP consulting team, it prevents the international donor community from reliably confirming whether the GOU is actually meeting credit and technical assistance conditionalities and from reliably confirming - and informing the international investor community of - the progress of Ukraine's privatization and economic reform programs.*

- * *Examples of non-transparency/lack of disclosure by the SPF to the donor community and their consultants: the SPF has not provided a list of the 6500 medium/large enterprises which it claims have reached 70%+ shares sold - since 1/1/95 - as of 10/1/97; the SPF has not provided a list of those enterprises which now have new share packages available for offering in future PPC and CC auctions; the SPF has not provided a list of "giant" enterprises which are subject to privatization and their status of privatization; the SPF has not provided a list of the 1240 medium/large enterprises which it claims were privatized prior to 1995 (i.e. prior to the MPP); the SPF (and CoM) has not provided a list of "strategic" enterprises which are to offer shares in international investment and cash tenders; the SPF has not provided a list of the hundreds of enterprises in which the state retains small (< 26% of shares) shareholdings and which it claims will be sold in cash auctions; et al.*

- * *Outside the framework of the MPP (i.e. outside of preferential share sales to employees and managers and to the public in PPC/CC auctions), Ukraine's privatization program becomes increasingly less transparent and more subject to abuse. While the safeguards built into the MPP ensure that it remains the most transparent, most "public", and most progressive of Ukraine's privatization and reform programs, there are few safeguards which apply to the SPF's commercial (cash) and non-commercial (investment) share sales programs. The SPF/CoM/GOU have not disclosed to the public - let alone the international donors - their track record regarding the latter forms of share sales. The SPF/CoM/GOU have generally not been eager to*

accept advice from the international donor community and their consultants in the drafting of cash and investment tender procedures.

- 3) *If the leadership of the GOU is serious about accelerating economic reform, about accelerating the privatization process, about completing the mass privatization of all eligible enterprises, about conducting an aggressive and transparent program to attract international (and domestic) investment, the GOU can immediately (with encouragement from the international donor community) do the following task:*
- * The SPF Chairman and management can sit down with the donors and their consultants and agree on a joint action plan for 1998 which will complete mass privatization - including “mass cash” share auctions - and initiate tenders to strategic investors in 1998 - with donor/consultant experience and assistance provided from the discussion through the planning, drafting and implementation phases.
 - * The SPF Chairman and management can agree to provide the consultants and the donors (and the public!) with complete access to all non-confidential/non-public domain information and data.

Mass Privatization Program in 1998: “Window of Opportunity”?

As indicated above, the Mass Privatization Program should not be viewed in isolation from Ukraine’s overall privatization and economic reform efforts. They are integrated and inseparable. The USAID/ PW Mass Privatization project could close shop at the end of May 1998 - when the task order officially ends - and declare “victory”, having privatized 8000 medium/large enterprises. While a significant accomplishment, mass privatization is only the first step in Ukraine’s economic reform program.

As the experience of the several countries in the FSU which have completed mass privatization programs (supported by USAID) have proven, the key to success of mass privatization is the successful and transparent transitioning from mass privatization to the sale of all remaining state shares, to the sale of shares in strategic enterprises for cash and investment commitments to international investors, and to the sale of small share packages for cash via the local markets.

In order to avoid the corruption and the creation of oligarchies created through (for example) the Russian “loans for shares” scheme - and the post-mass privatization failures of other FSU and central European republics, key aspects of the Ukraine MPP must be applied to other forms of share sales going forward, i.e. transparency, speed, auction sales to the highest bidder, public disclosure of auction results, et al.

The “window of opportunity” provided by Ukraine’s MPP to the GOU (and to the international donor community) in 1998 is a period during which time the GOU can - with international encouragement and technical assistance - be influenced to adopt truly transparent and accelerated means to complete the MPP and transition to strategic enterprise share sales. If this window of opportunity is utilized to successfully transfer the transparency and speed of mass privatization to other forms of share sales, then an environment in which enterprise restructuring can be effectively implemented and in which the creation of new small and medium scale enterprises can be encouraged will be much more likely to become a reality.

III. Key Project Outputs

Privatization Strategy Advisory Team

- Reviewed draft regulation on conducting international tenders drafted by the SPF.
- Reviewed legal documents governing privatization and management of the air transport sector.
- Drafted and submitted to the SPF proposals on changes to the draft *Law on Securities and Stock Exchanges*
- Prepared and submitted to the SPF a legal analysis of the draft *Law on Indexation of JSCs' Statutory Capital*
- Drafted and submitted to the SPF proposals to the *Procedure of Conducting Certificate Auctions*, approved by CoM Decree # 218, regarding introduction of minimum share nominal value of 1 kopeck.
- Drafted and submitted to the SPF proposals on changes to the SPF Order # 618 *On Procedure of Submitting for Publication in Vidomosti Pryvatyzatsii Newspaper of Information on Sale of JSCs Shares in Certificate Auctions* regarding publication/disclosure of information on enterprises against which a bankruptcy case was filed.
- Incorporated the SSMC suggestions to the draft joint SPF/SSMC *Regulation on Compilation of Shareholder Registries in the Result of Privatization* and submitted the draft to the SSMC and the SPF for review and approval.
- Assisted the SPF in calculating an approximate number of PPCs invested in state property since initiation of privatization.
- Provided proposals to the SPF to allow bidders to purchase remainders of shares for the remainders on privatization deposit accounts in cases when the value of the deposit account remainder is greater than the value of shares remaining unsold.
- Prepared an analysis of CoM Order #1218 (re KU) identifying new contradictions with existing legislation/procedures.

Privatization Data Analysis Team

- Assisted the SPF to verify data for the 36th PPC and 21st CC auctions.
- Prepared and provided counterparts with analytical notes on offered share lots for 36th PPC, 21st CC auctions and on 34^d PPC and 19th CC auctions results.
- Updated the auction and certificates distribution statistics.
- Based on the latest verified data, revised the electronic list of enterprises which have been planned for privatization during 1995-1998. The current list consists of 10,788 large enterprises.
- Provided the SPF with an analytical note with recommendations to revise the list of “strategic” enterprises.
- Prepared draft analysis of the regional breakdown of “Top 200” enterprises.
- Prepared draft analysis of “PPC and CC auctions information flow” with recommendations on how to improve it.
- Provided the SPF Restructuring and Pre-privatization Support Department (PRPSD) with analysis on privatization status of “strategic” enterprises.
- Following a PRPSD request, compiled data and prepared a report on the privatization status of all enterprises subordinated to the Ministry of Communication (including Telecoms).
- Compiled information about all enterprises to undergo bankruptcy procedures.
- Prepared and conducted presentation and EXCEL and ACCESS training for Regional Information Coordinators (RICs).
- Distributed a list of grain industry enterprises to the RICs for regional verification. Agreed with the SPF IT Department on support to RICs’ activity in the regions.
- Continued verification of various data on the regional level.

- Agreed with the SPF on an enterprise-specific list of grain-industry enterprises subject to the World Bank's EDAL II conditions.
- Updated and provided the SPF with an analysis of the privatization status of all AIC and EDAL II AIC enterprises undergoing privatization.
- Prepared a statistical analysis of "Energos Capitalization".
- Updated data on group D enterprises' Share Allocation Plans' approval status. Modified relevant software in order to better satisfy the SPF's needs.
- Started work with the PFTS (OTC Exchange) and SPF Stock Exchange Department on State's shares sales data.
- Conducted several training seminars for SPF Share Sales and AIC Departments on EXCEL and ACCESS software.
- Continued to provide in-house analytical support to several SPF departments.

Enterprise Preparation

- Assisted RPFs to prepare 100 new enterprise information packages for the 36th PPC auction, including 6 oblenergo companies.
- Assisted RPFs to prepare 214 enterprise information packages for the 22nd CC auction.
- Identified 13 new Central Apparat enterprises to receive direct enterprise preparation assistance in 1998.
- Prepared share allocation plans and provided other consulting services to 35 Khib Ukrainy enterprises.
- Provided direct technical assistance to 23 large Group C and D enterprises.
- Consolidated information on "Red October" plant in Fastiv (Kyiv Oblast) for a case study.
- Conducted preparatory work for Khib Ukrainy seminars in Zaporizhye, Cherkassy, Lugansk and Uzhgorod, and free share transfer meetings in Chernigiv and Uzhgorod.
- Continued advising numerous enterprises, including Dniiproenergo (one of Ukraine's four thermo power generating plants), on the regional level on enterprise preparation procedures.
- Completed verification of DRZOU codes of selected enterprises, comparing SPF with Ministry of Statistics data.
- Completed verification of AIC enterprises which existed in ETAP by May 1st but which seemed to vanish from the database by December 10th.

Auction Center Network (ACN)

ACN Consulting/Certificate Auction Support

- Completed the ACN evaluation for November 1997: the ACN earned a total of \$153,596. The ACN reached 100% of the target only in the "PPC collection" category. The percentage of CC collection decreased in November to 29%.
- The UCCA submitted to PW confirmation of money transfers to the RCCAs for the October ACN evaluation according to the PW Instruction Letter.
- Provided regions with the latest information on the results of the 34th PPC Auction and 19th CC Auction so that RPFs could revise Share Allocation Plans and prepare more packages for the upcoming auctions.
- Drafted the MoU on cooperation between PW and SPF (re ACN), conducted meetings with heads of different SPF departments discussing the MoU. Presented the final version of the MoU to the Acting SPF Chairman for signature.

ACN Systems Support

- Changes were made in Chernivtsi, Lviv, Luhansk, and Kharkiv RCCA LANs. Satellite Stations were allocated in separate LAN segments to protect LAN resources from inadmissible external access and to avoid network packets forwarding through the Satellite. New software increases processing and transfer speed from 5 up to 300%.

- Continued maintenance and user guidance for the various live systems including CC and PPC bid collection and auction processing systems, financial intermediaries data processing system.
- Several training seminars for SPF (4) and UCCA (4) staff on the ACN systems.
- Prepared training materials and outlines for SPF training.
- Detected and recommend solutions to problems related to a hard disk drive failure from August 1997 and its replacement with a new one, in the process of the subsequent operation of a Compaq Proliant 1500 server.
- Continued ACN and project users support.

Monitoring ACN Activity

- Performed review of accounting documentation and internal controls (jointly with UCCA representatives): Zaporizhia and Simferopol RCCAs (SPF/RPF individuals were invited and encouraged to participate, but declined to do so in the absence of a relevant Order from senior SPF officials).
- Prepared working papers for Zaporizhia and Simferopol RCCA audit visits.
- Finalized and sent Audit Report of Findings for Volyn, Poltava, and Sumy RCCAs.
- Conducted technical review of the following reports: Zaporizhia and Donetsk RCCAs.
- Submitted proposal regarding training seminar and joint audits to Mrs. Ledomska and subsequently to Mr. Babich at the SPF.

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Major Privatization Events in January:

Agreement on Privatization Targets: Donors (including USAID, IMF, World Bank) - based on analysis of Government of Ukraine/State Property Fund data - agreed that 9500 medium/large enterprises is a realistic privatization target for the GOU/SPF by September 30, 1998. (If the target is reached, the mass privatization program and medium/large enterprise privatization will have essentially been completed.)

- Vice Prime Minister Tyhypko agreed to privatization targets during his Washington meetings with donors in late January.
- PW Mass Privatization project team drafted an Order (for the donors to propose to Vice Prime Minister Tyhypko) which would order the SPF to prepare a month-by-month plan (and to provide biweekly progress reports to the Vice PM) for the privatization (>70% shares sold) of 2500 medium/large enterprises from January through September 1998 - in order to reach the 9500 target by the end of September.
- PW MPP team drafted an Order (to be proposed to the management of the SPF) which would instruct the regional offices of the SPF and the SPF headquarters to prepare 500 (of the roughly 2500 in the “pipeline”) enterprises to offer shares which will enable each of them to reach more than 70% shares sold in the mid-March Compensation Certificate (CC) Auction.
- PW MPP team completed privatization universe data analysis. The analysis indicates that 2500 medium/large enterprises are in the privatization “pipeline” and can be privatized (>70% shares sold) by September 30, 1998.
- In other words, 7000 medium/large enterprises privatized as of 1/1/98 + 2500 enterprises to be privatized over the next nine months = 9500 medium/large enterprises privatized by 9/30/98.
- In other words, by the end of the third quarter of 1998, Ukraine’s program of privatization of its medium/large enterprises should be completed.

1998 Privatization Program

- If the President’s (GOU’s) 1998 Privatization Program is adopted by the Parliament, certificate auctions will end on June 30, 1998. Which means that approximately 2000 medium/large enterprises will remain in limbo and will be unable to be fully privatized in 1998. Thus, the President’s/GOU Program is a worse alternative than continuation of the 1997 Program (the latter would allow certificate auctions to continue to at least the end of the year). (It may be surprising, but the proposal of Parliament Speaker Moroz to continue the 1997 Program through 1998 is in fact a more progressive proposal than the 1998 Program presented to Parliament by the President).
- Our analysis indicates that only 200 - of the 9500 enterprises in Ukraine’s medium/large enterprise universe - are of interest to strategic investors and might attract serious international (and “offshore” domestic) investment.

- Any remaining state shareholdings in the other 9300 enterprises will not attract other than minimal cash and should be sold for compensation certificates (and/or for cash with no floor price) in order to finally eliminate state ownership, state interference and the drain on the state budget in support of these enterprises.
- For Ukraine's privatization program to be completed, Compensation Certificate Auctions must continue to the end of 1998 - which will happen if the President's/GOU's 1998 Privatization Program is rejected and the 1997 Privatization Program continues through the end of 1998 (or the Parliament adopts a 1998 Privatization Program which extends CC auctions and minimum share sales for certificates quotas through year end).

Major PW MPP Team Outputs in January:

Privatization Strategy/Policy

- Attempted to promote to the SPF/GOU/USAID/donors extension of Compensation Certificate distribution. Compensation Certificates - originally sponsored by USAID and supported by the GOU in mid-1995 - have received no political support in 1997/98. Distribution to the public officially ended on 12/31/97.
- Attempted to promote to the SPF/GOU/USAID/donors extension of Mass Privatization/Certificate Auctions to the end of 1998. No official support for this effort led to the GOU's proposal to end mass privatization on June 30, 1998.
- Attempted to promote to the SPF/USAID/donors monthly Compensation Certificate and Privatization Certificate auction plans by the SPF - in order to reach the 9500 target. Have to date failed to receive support.
- Began consulting to the SPF for the drafting of the "Law on Privatization of Strategic Enterprises".
- Determined 2500 additional enterprises can be privatized (reach > 70% shares sold) by Sep 30, 1998.
- Initiated restructuring and privatization preparation including legal/technical assistance to the State Committee on Communications for the privatization of Ukrtelecom beginning in mid-1998.
- Initiated legal reviews for the privatization of the air transport sector/Air Ukraine beginning in mid-1998.
- Conducted analyses of the first commercial/cash tenders which were conducted in January for 20% share packages of seven electric power companies.

Preparation of Enterprises for Privatization

- Eliminated PW MPP consulting in rural oblasts. Redeployed PW MPP regional consultants to six major, industrial regions (Kyiv, Lviv, Zaporhizhia, Donetsk, Dnipropetrovsk, Odesa) to consult on preparing largest enterprises for privatization.
- Continued enterprise preparation consulting to large (generally "Group D") enterprises in these regions (currently 17 Group D enterprises, 14 ex-Khlib Ukrainy elevators, and 15 SPF "Central Office" enterprises).
- Conducted regional Khlib Ukrainy (KU) privatization preparation training seminars for 200 ex-KU managers, regional SPF officials, and local government officials. (*Note: The SPF is being urged by us to urgently take the initiative to obtain GOU legal clarification regarding the free transfer of shares to employees of the suppliers of ex-KU and other agro-industrial enterprises. Prosecutors are challenging such free share transfers, and thus slowing KU/agro-industrial privatization, as a result of the lack of clear legal procedures for the allocation of shares and their free transfer to employees of suppliers.*)

- Prepared for enterprise valuation/accounting enterprise preparation seminars in February for major enterprises in the six regions.
- Assigned 20 regional information consultants - with regional consultant management direction - the task of assisting regional SPF offices to prepare enterprise share packages and conduct related data analyses for monthly CC and PPC auctions.

Counterpart Training/Skills Transfer

- SPF Chairman signed the SPF/PW(USAID) Memorandum of Understanding for the transfer of the PW/USAID Auction Center Network financing, IT systems management and certificate auction audit functions to the SPF and its regional branches - with training to be provided by the PW MPP team between January and May 1998.
- Began second month of training of six State Property Fund IT managers to assume responsibility for managing the national certificate auction IT programming and software development/maintenance functions.
- After nearly one year of attempts by the PW MPP team, the SPF finally assigned its audit managers to participate jointly with the PW MPP audit team in an operational compliance review (of the Kherson Auction Center), thus representing the initiation of the transfer of the certificate auction audit tasks to the SPF. A formal training program for the SPF audit team will begin next week in Kyiv.

Final USAID Funding of Auction Center Network

The final USAID funding of the Auction Center Network (performance based financing for the month of December) was paid, thus ending all USAID financial assistance for the ACN payroll and infrastructure following three years of start-up and operating financial support. Financing is henceforth assumed by the State Property Fund/GOU.

Final Task Order Initiatives

Drafted and presented to USAID final work plan for 1998 (through end of project funding).

Major Current Privatization Issues:

1) Final Phase of USAID Technical Assistance

January 1998 represents the first month of the final phase of the USAID/PW Mass Privatization project. With the ending of USAID technical assistance for Ukraine's Mass Privatization Program in a few months time, the focus of the project team, the donor community and the SPF/GOU is on accelerated completion of Ukraine's privatization program in 1998.

2) "Mass" Privatization versus "Cash" Privatization?

It is important to note that the SPF/GOU, as incorporated in the government's proposed 1998 Privatization Program, seek to separate mass/certificate privatization from cash privatization. The leadership of the GOU, under pressure to raise revenues for the budget, proposes that mass privatization must end as soon as possible and a "second phase" of privatization - of share sales exclusively for cash - must begin in 1998. This concept is in fact unrealistic and ignores developments in Ukraine's privatization program over the past three years:

a) *"Mass" privatization and "cash" privatization are part of the same integrated process:*

- Cash privatization has been going on - in conjunction with certificate auctions - for at least the past three years - it is not a new "second phase".

- Ukraine's largest industrial enterprises, per the terms of the 1997 Privatization Program, are required to sell 25% of their shares to employees and to the public for certificates, then to sell remaining shares (excluding shareholdings retained by the state) for cash via commercial (cash) tenders, non-commercial (future investment) tenders, and/or via local stock markets. This process has been underway for the past three years. In other words, "cash" privatization is not something new to 1998 - but has been undertaken (under less formal terms) since independence in August 1991 and (formally) since the mass privatization program began in early 1995.
- Although the GOU and the media state that in 1998 Ukraine will begin cash privatization of its strategic enterprises, this process has been underway for the past six years. Many of Ukraine's largest and most attractive enterprises (approximately 1240 medium/large enterprises) were privatized via employee lease buyouts/cash share purchases prior to 1995. Some of Ukraine's household brands - including Nord Refrigerators, Svitoch Chocolates, Obolon Beer - were privatized by their employees and management prior to 1995.
- Ukraine's 100 largest enterprises produce sales revenues equal to nearly 50% of Ukraine's GDP. Of these 100 largest enterprises, most are already privatized or are in the process of privatizing (via share sales for certificates to employees and the public and commercial/non-commercial tenders).
- For example, the metallurgy (iron ore, steel and related) industry generates 36% (the largest share) of the sales revenues produced by these 100 largest enterprises. Within the metallurgy industry: 50% of enterprises have sold shares in PPC auctions. 44% have sold more than 40% of their shares. 25% of metallurgy industry enterprises have sold more than 70% of their shares.
- Within the electric power sector, all enterprises have started or completed share sales to employees for certificates, 63% have completed share auctions to the public for certificates, four have offered shares on local stock markets, and eight have conducted commercial/cash tenders.
- In other words, "cash" privatization - including "cash" privatization of "attractive/strategic" enterprises - is not something new for 1998. It has been underway for the past six years.

b) *What is required to complete privatization and generate cash for the budget in 1998?*

Mass privatization/certificate auctions are the "engine" which initiates the privatization - and cash share sales generation for the budget - of Ukraine's largest/most attractive enterprises. The initial, strong incentive - the desire of employees, managers, the public and investment funds to use certificates to purchase shares in such enterprises - is critical to initiating privatization and to getting shares into the secondary market.

Without mass privatization, enterprise managers, industrial branch ministry officials, bureaucrats and politicians would be left to squabble over how to conduct share sales and how to divide the proceeds (as happens when an enterprise completes the certificate auction phase of privatization), thus delaying the start of privatization.

Real cash generation for the budget will only happen if the state is willing to sell - at prices set by the market - the large stakes it holds in nearly all of Ukraine's largest enterprises. For example, international strategic investors are not showing interest in investment in the electric power distribution companies which have recently offered shares in commercial tenders. Why?

- Because the investor obtains a 20% shareholding while the government retains a 26% or 51% controlling interest.

- Because the investor is required to make long-term investments while having no say in how such investments should be utilized.
- And because the investor is required to pay several times over the market price for the shares (a market price which can be determined because shares sold via certificate auctions have entered an active secondary market).

While the state must be willing to sell its retained shareholdings in large, attractive enterprises at market prices (which means, if necessary, selling below nominal/book value), there is a different problem for the thousands of other, less attractive enterprises in which the state retains shareholdings. The majority of these enterprises are partially privatized with the state retaining from a few % to more than 30% of shares. Based upon Privatization Certificate auction results, the state cannot expect to generate significant revenues from the sale of its remaining shareholdings, particularly if the GOU/SPF maintains a floor price/nominal value minimum price.

The only effective mechanism to quickly eliminate state shareholdings (and state interference and control over) partially privatized enterprises is for the state to sell all remaining state shares in Compensation Certificate auctions (which allow for share sales below nominal value) or, less likely, in cash sales via the OTC market at prices determined by the market.

c) *In summary, the GOU/SPF can complete its privatization program and generate cash for the budget by the end of 1998 by:*

- Extending CC auctions and distribution (for all remaining state shares outside of the 200+/- “strategic” enterprises) and PPC auctions (only for the auctioning of share packages to the public of those largest, attractive enterprises which have yet to offer shares in PPC auctions) to the end of 1998.
- Ordering the SPF to prepare - and provide fortnightly updates on - a region and enterprise specific plan to privatize (> 70% shares sold) 2500 medium/large enterprises between January and the end of September 1998 in order to reach 9500 medium/large enterprises sold by the end of the third quarter of 1998.
- Ordering the SPF to prepare for the offering of 400 to 500 enterprises to offer maximum shares - in order to reach more than 70% total shares sold - in CC auctions each month, March - September 1998. (The January/February CC auctions will each generate fewer than 50 enterprises > 70% sold.)
- Ordering the SPF to conduct commercial and non-commercial tenders and cash auctions for the shares of the 200 strategic enterprises at market-determined prices, i.e. for the highest bid.
- Ordering the Cabinet of Ministers to prepare the telecoms sector for privatization beginning in the second half of 1998 with a draft privatization proposal - for removal of telecoms from the Parliament’s privatization “Negative List” - to be submitted to the new Parliament. (Outside of telecoms, there are currently no other major industrial sectors on the Negative List, other than railroads, which might be of interest to strategic investors.)

FEBRUARY 1998 PROGRESS REPORT

February 1998 was one of the most productive and momentous months in the history of Ukraine's privatization program:

Major Privatization Events in February:

- The Parliament adopted the 1998 Privatization Program which provides for extension of Privatization Certificate (PPC) and Compensation Certificate (CC) distribution through mid-1998 and PPC and CC auctions through the end of 1998 and the sale of shares *for the first time* at the market price (below nominal/book value).
- Vice Prime Minister Tyhypko ordered the State Property Fund (SPF) to develop, implement and report fortnightly on plans to meet the World Bank and IMF privatization targets of 8500 medium/large enterprises agreed to privatization targets during his Washington meetings with donors in late January.
- PW Mass Privatization project team drafted an Order (for the donors to propose to Vice Prime Minister Tyhypko) which would order the SPF to prepare a month-by-month plan (and to provide biweekly progress reports to the Vice PM) for the privatization (>70% shares sold) of 2500 medium/large enterprises from January through September 1998 - in order to reach the 9500 target by the end of September.
- PW MPP team drafted an Order (to be proposed to the management of the SPF) which would instruct the regional offices of the SPF and the SPF headquarters to prepare 500 (of the roughly 2500 in the "pipeline") enterprises to offer shares which will enable each of them to reach more than 70% shares sold in the mid-March Compensation Certificate (CC) Auction.
- PW MPP team completed privatization universe data analysis. The analysis indicates that 2500 medium/large enterprises are in the privatization "pipeline" and can be privatized (>70% shares sold) by September 30, 1998.
- In other words, 7000 medium/large enterprises privatized as of 1/1/98 + 2500 enterprises to be privatized over the next nine months = 9500 medium/large enterprises privatized by 9/30/98.
- In other words, by the end of the third quarter of 1998, Ukraine's program of privatization of its medium/large enterprises should be completed.

1998 Privatization Program

- If the President's (GOU's) 1998 Privatization Program is adopted by the Parliament, certificate auctions will end on June 30, 1998. Which means that approximately 2000 medium/large enterprises will remain in limbo and will be unable to be fully privatized in 1998. Thus, the President's/GOU Program is a worse alternative than continuation of the 1997 Program (the latter would allow certificate auctions to continue to at least the end of the year). (It may be surprising, but the proposal of Parliament Speaker Moroz to continue the 1997 Program through 1998 is in fact a more progressive proposal than the 1998 Program presented to Parliament by the President).
- Our analysis indicates that only 200 - of the 9500 enterprises in Ukraine's medium/large enterprise universe - are of interest to strategic investors and might attract serious international (and "offshore" domestic) investment.

- Any remaining state shareholdings in the other 9300 enterprises will not attract other than minimal cash and should be sold for compensation certificates (and/or for cash with no floor price) in order to finally eliminate state ownership, state interference and the drain on the state budget in support of these enterprises.
- For Ukraine's privatization program to be completed, Compensation Certificate Auctions must continue to the end of 1998 - which will happen if the President's/GOU's 1998 Privatization Program is rejected and the 1997 Privatization Program continues through the end of 1998 (or the Parliament adopts a 1998 Privatization Program which extends CC auctions and minimum share sales for certificates quotas through year end).

Major PW MPP Team Outputs in January:

Privatization Strategy/Policy

- Attempted to promote to the SPF/GOU/USAID/donors extension of Compensation Certificate distribution. Compensation Certificates - originally sponsored by USAID and supported by the GOU in mid-1995 - have received no political support in 1997/98. Distribution to the public officially ended on 12/31/97.
- Attempted to promote to the SPF/GOU/USAID/donors extension of Mass Privatization/Certificate Auctions to the end of 1998. No official support for this effort led to the GOU's proposal to end mass privatization on June 30, 1998.
- Attempted to promote to the SPF/USAID/donors monthly Compensation Certificate and Privatization Certificate auction plans by the SPF - in order to reach the 9500 target. Have to date failed to receive support.
- Began consulting to the SPF for the drafting of the "Law on Privatization of Strategic Enterprises".
- Determined 2500 additional enterprises can be privatized (reach > 70% shares sold) by Sep 30, 1998.
- Initiated restructuring and privatization preparation including legal/technical assistance to the State Committee on Communications for the privatization of Ukrtelecom beginning in mid-1998.
- Initiated legal reviews for the privatization of the air transport sector/Air Ukraine beginning in mid-1998.
- Conducted analyses of the first commercial/cash tenders which were conducted in January for 20% share packages of seven electric power companies.

Preparation of Enterprises for Privatization

- Eliminated PW MPP consulting in rural oblasts. Redeployed PW MPP regional consultants to six major, industrial regions (Kyiv, Lviv, Zaporhizhia, Donetsk, Dnipropetrovsk, Odesa) to consult on preparing largest enterprises for privatization.
- Continued enterprise preparation consulting to large (generally "Group D") enterprises in these regions (currently 17 Group D enterprises, 14 ex-Khlib Ukrainy elevators, and 15 SPF "Central Office" enterprises).
- Conducted regional Khlib Ukrainy (KU) privatization preparation training seminars for 200 ex-KU managers, regional SPF officials, and local government officials. *(Note: The SPF is being urged by us to urgently take the initiative to obtain GOU legal clarification regarding the free transfer of shares to employees of the suppliers of ex-KU and other agro-industrial enterprises. Prosecutors are challenging such free share transfers, and thus slowing KU/agro-industrial privatization, as a result of the lack of clear legal procedures for the allocation of shares and their free transfer to employees of suppliers.)*

- Prepared for enterprise valuation/accounting enterprise preparation seminars in February for major enterprises in the six regions.
- Assigned 20 regional information consultants - with regional consultant management direction - the task of assisting regional SPF offices to prepare enterprise share packages and conduct related data analyses for monthly CC and PPC auctions.

Counterpart Training/Skills Transfer

- SPF Chairman signed the SPF/PW(USAID) Memorandum of Understanding for the transfer of the PW/USAID Auction Center Network financing, IT systems management and certificate auction audit functions to the SPF and its regional branches - with training to be provided by the PW MPP team between January and May 1998.
- Began second month of training of six State Property Fund IT managers to assume responsibility for managing the national certificate auction IT programming and software development/maintenance functions.
- After nearly one year of attempts by the PW MPP team, the SPF finally assigned its audit managers to participate jointly with the PW MPP audit team in an operational compliance review (of the Kherson Auction Center), thus representing the initiation of the transfer of the certificate auction audit tasks to the SPF. A formal training program for the SPF audit team will begin next week in Kyiv.

Final USAID Funding of Auction Center Network

The final USAID funding of the Auction Center Network (performance based financing for the month of December) was paid, thus ending all USAID financial assistance for the ACN payroll and infrastructure following three years of start-up and operating financial support. Financing is henceforth assumed by the State Property Fund/GOU.

Final Task Order Initiatives

- Drafted and presented to USAID final work plan for 1998 (through end of project funding).

Major Current Privatization Issues:

1) Final Phase of USAID Technical Assistance

January 1998 represents the first month of the final phase of the USAID/PW Mass Privatization project. With the ending of USAID technical assistance for Ukraine's Mass Privatization Program in a few months time, the focus of the project team, the donor community and the SPF/GOU is on accelerated completion of Ukraine's privatization program in 1998.

2) "Mass" Privatization versus "Cash" Privatization?

It is important to note that the SPF/GOU, as incorporated in the government's proposed 1998 Privatization Program, seek to separate mass/certificate privatization from cash privatization. The leadership of the GOU, under pressure to raise revenues for the budget, proposes that mass privatization must end as soon as possible and a "second phase" of privatization - of share sales exclusively for cash - must begin in 1998. This concept is in fact unrealistic and ignores developments in Ukraine's privatization program over the past three years:

a) *"Mass" privatization and "cash" privatization are part of the same integrated process:*

1. Cash privatization has been going on - in conjunction with certificate auctions - for at least the past three years - it is not a new "second phase".

2. Ukraine's largest industrial enterprises, per the terms of the 1997 Privatization Program, are required to sell 25% of their shares to employees and to the public for certificates, then to sell remaining shares (excluding shareholdings retained by the state) for cash via commercial (cash) tenders, non-commercial (future investment) tenders, and/or via local stock markets. This process has been underway for the past three years. In other words, "cash" privatization is not something new to 1998 - but has been undertaken (under less formal terms) since independence in August 1991 and (formally) since the mass privatization program began in early 1995.
3. Although the GOU and the media state that in 1998 Ukraine will begin cash privatization of its strategic enterprises, this process has been underway for the past six years. Many of Ukraine's largest and most attractive enterprises (approximately 1240 medium/large enterprises) were privatized via employee lease buyouts/cash share purchases prior to 1995. Some of Ukraine's household brands - including Nord Refrigerators, Svitoch Chocolates, Obolon Beer - were privatized by their employees and management prior to 1995.
4. Ukraine's 100 largest enterprises produce sales revenues equal to nearly 50% of Ukraine's GDP. Of these 100 largest enterprises, most are already privatized or are in the process of privatizing (via share sales for certificates to employees and the public and commercial/non-commercial tenders).
5. For example, the metallurgy (iron ore, steel and related) industry generates 36% (the largest share) of the sales revenues produced by these 100 largest enterprises. Within the metallurgy industry: 50% of enterprises have sold shares in PPC auctions. 44% have sold more than 40% of their shares. 25% of metallurgy industry enterprises have sold more than 70% of their shares.
6. Within the electric power sector, all enterprises have started or completed share sales to employees for certificates, 63% have completed share auctions to the public for certificates, four have offered shares on local stock markets, and eight have conducted commercial/cash tenders.
7. In other words, "cash" privatization - including "cash" privatization of "attractive/strategic" enterprises - is not something new for 1998. It has been underway for the past six years.

b) *What is required to complete privatization and generate cash for the budget in 1998?* Mass privatization/certificate auctions are the "engine" which initiates the privatization - and cash share sales generation for the budget - of Ukraine's largest/most attractive enterprises. The initial, strong incentive - the desire of employees, managers, the public and investment funds to use certificates to purchase shares in such enterprises - is critical to initiating privatization and to getting shares into the secondary market.

Without mass privatization, enterprise managers, industrial branch ministry officials, bureaucrats and politicians would be left to squabble over how to conduct share sales and how to divide the proceeds (as happens when an enterprise completes the certificate auction phase of privatization), thus delaying the start of privatization.

Real cash generation for the budget will only happen if the state is willing to sell - at prices set by the market - the large stakes it holds in nearly all of Ukraine's largest enterprises. For example, international strategic investors are not showing interest in investment in the electric power distribution companies which have recently offered shares in commercial tenders. Why?

- Because the investor obtains a 20% shareholding while the government retains a 26% or 51% controlling interest.

- Because the investor is required to make long-term investments while having no say in how such investments should be utilized.
- And because the investor is required to pay several times over the market price for the shares (a market price which can be determined because shares sold via certificate auctions have entered an active secondary market).

While the state must be willing to sell its retained shareholdings in large, attractive enterprises at market prices (which means, if necessary, selling below nominal/book value), there is a different problem for the thousands of other, less attractive enterprises in which the state retains shareholdings. The majority of these enterprises are partially privatized with the state retaining from a few % to more than 30% of shares. Based upon Privatization Certificate auction results, the state cannot expect to generate significant revenues from the sale of its remaining shareholdings, particularly if the GOU/SPF maintains a floor price/nominal value minimum price.

The only effective mechanism to quickly eliminate state shareholdings (and state interference and control over) partially privatized enterprises is for the state to sell all remaining state shares in Compensation Certificate auctions (which allow for share sales below nominal value) or, less likely, in cash sales via the OTC market at prices determined by the market.

c) *In summary, the GOU/SPF can complete its privatization program and generate cash for the budget by the end of 1998 by:*

1. Extending CC auctions and distribution (for all remaining state shares outside of the 200+/- "strategic" enterprises) and PPC auctions (only for the auctioning of share packages to the public of those largest, attractive enterprises which have yet to offer shares in PPC auctions) to the end of 1998.
2. Ordering the SPF to prepare - and provide fortnightly updates on - a region and enterprise specific plan to privatize (> 70% shares sold) 2500 medium/large enterprises between January and the end of September 1998 in order to reach 9500 medium/large enterprises sold by the end of the third quarter of 1998.
3. Ordering the SPF to prepare for the offering of 400 to 500 enterprises to offer maximum shares - in order to reach more than 70% total shares sold - in CC auctions each month, March - September 1998. (The January/February CC auctions will each generate fewer than 50 enterprises > 70% sold.)
4. Ordering the SPF to conduct commercial and non-commercial tenders and cash auctions for the shares of the 200 strategic enterprises at market-determined prices, i.e. for the highest bid.
5. Ordering the Cabinet of Ministers to prepare the telecoms sector for privatization beginning in the second half of 1998 with a draft privatization proposal - for removal of telecoms from the Parliament's privatization "Negative List" - to be submitted to the new Parliament. (Outside of telecoms, there are currently no other major industrial sectors on the Negative List, other than railroads, which might be of interest to strategic investors.)

Parliamentary Elections and the Privatization Program

Parliamentary elections for new deputies to the Verkhovna Rada (VR) resulted in the Communist and Socialist parties securing more than one-third of the seats - about 157 - in the 450 member VR. 157 is less than the 226 majority need to amend the Constitution, pass legislation and overturn Presidential vetoes. The success of the leftists in halting or slowing the privatization program will greatly depend on their success in developing issue-specific coalitions with the 16 radical socialist (Progressive Socialist Party) deputies, the 23 centrist (and anti-Kuchma) Hromada deputies and some independent deputies.

Offsetting these 200 +/- votes are the 109 seats won by centrist/rightist parties and the 114 independents elected to the VR. The latter are expected to be generally supportive of privatization and reforms, particularly given the large number of business people elected as independents.

In sum, it appears that the new VR will be unable to prevent the GOU from continuing with implementation of the privatization program. In terms of the pace of privatization, the elections probably mean more of the same, i.e. the progressive 1998 Privatization Program (adopted by the VR with significant leftist/Socialist support) will not be overturned or amended. Which means that the mass privatization program can continue to completion by early 1999. However, at the same time, it is expected that the leftists in the new VR - which takes office during the first week of May - will attempt to pass resolutions and legislation which may disrupt the privatization program.

It is at this time unclear as to how the President/the Presidential Administration and the Cabinet of Ministers will respond to the election results and their potential for a negative impact on the country's privatization program. Our estimation is that the election results mean that the GOU will continue with its current privatization initiatives. There is also the faint hope that the GOU, based upon the results of the election, might decide to order more radical steps to accelerate the pace of mass privatization/certificate auctions and the sale of large share packages for cash to strategic investors - as a response to voters' disenchantment with the slow pace of reforms, the 90% public participation in the certificate auction program, and the public's general understanding that the state is bankrupt - and that their future prosperity lies not in a state-owned economy nor in Moscow - but in their own hands.

The signals from the GOU in late March/first week of April regarding its post-election privatization strategy is mixed. On the one hand, last week the Prime Minister ordered the State Property Fund to halt privatization of the electric utilities, claiming that they are being sold "too cheaply". "Too cheaply" is contradicted by the SPF's latest announced - prior to the Prime Minister's order - cash tender for "Kyivoblenergo" at a starting price of 250% of the market (OTC) price for shares in the company.

It is as yet unclear what the order actually means - does it apply only to the sale of small share packages on local stock exchanges (which have in fact been sold by the SPF above nominal value)? Or does it also apply to cash and investment tenders being conducted for the regional electric distribution companies? And to international tenders for advisors and strategic investors being conducted for three of the four electric generating companies?

The risk inherent in the Prime Minister's order is that, if the GOU halts the sale of the energy companies and other very large, most attractive enterprises, the privatization of Ukraine's "blue chips" - except for share sales to employees and the public for certificates - will be stalled. This would delay these blue chip enterprises from attracting necessary investment and strategic investors, would impede the SPF/GOU's efforts to raise UAH 1 billion (USD 500 mil) in privatization

revenues in 1998, would continue to drain the state budget in terms of financial support for these enterprises and would indefinitely delay their final/full privatization.

While the Prime Minister's orders and pronouncements regarding privatization over the past few weeks are cause for concern (and perhaps indicate a general lack of understanding of the objectives and process of Ukraine's privatization program), last week's nomination by the President of Alexander Bondar to be the new SPF Chairman is a positive development. Bondar has been deputy chairman and first deputy chairman of the SPF from the beginning of its establishment. Having overseen the successful completion of Ukraine's small-scale privatization program, Bondar is a very experienced and pragmatic manager who can be expected to significantly de-politicize and accelerate the privatization program. (Bondar has also generally been the SPF's representative to the VR - which should mean that he stands a better chance of being approved as Chairman by the VR.)

While the political environment is undergoing change, the USAID/PW Mass Privatization project team has been working closely with SPF management to implement new initiatives in response to Vice Prime Minister's Tyhypko's orders to the SPF to meet USG/World Bank/IMF privatization conditionalities for 1998 including the 9500 enterprise privatization target (for end September 1998) and targets for the demonopolization and privatization of Khib Ukrainy/the grain sector.

Despite the political uncertainties, March 1998 was - as measured by the number of new initiatives proposed to and adopted/implemented by the State Property Fund - one of the most productive months for Ukraine's privatization program:

Privatization Strategy and Policy Consulting and Data Analysis

During the month of March, the PW MPP team drafted - and the State Property Fund/GOU approved and adopted - the following regulations and new initiatives for acceleration of Ukraine's privatization program:

- Vice Prime Minister Tyhypko issued an order to the SPF to develop a month-by-month plan (by late March/early April) to reach 9500 large/medium enterprises privatized (>70% sold) by the end of September 1998.
- In response, the SPF issued an order to the SPF and its Regional Property Fund (RPF) branches to (with PW MPP and IFC consulting assistance) conduct a complete review of all SPF/RPF data in the SPF's "ETAP" database and RPF paper files to more precisely estimate how many enterprises can be privatized between now and the end of September.
- The numbers proposed by the RPF's - and to be approved by the SPF - are to serve as the basis for each RPF's (and the SPF Central Office's) "plan graphic" for the next several months. Penalties, including dismissals of RPF managers, will be ordered by the Vice Prime Minister for those not fulfilling agreed plans.
- In conducting this verification project, the number of medium/large enterprises which have reached 70%+ sold since January 1995 and those which have not reached 70% sold are being identified along with the specific obstacles which are delaying share sales by these latter enterprises in the privatization "pipeline".
- This verification process represents a radical new - and first step - by the management of the SPF to promote full, complete and honest reporting of privatization data. The SPF in March published for the first time its list of all 8700 enterprises privatized since Jan 1992. Publication vehicles included the SPF's (PW MPP supported) "Mass Privatization in Ukraine" Web Site.

- The new management of the SPF has committed to full transparency and to honest reporting of all privatization data to the public and the international donors. In this regard, the management of the SPF this month admitted that the 7500 large/medium enterprises privatized since Jan 1995 figure - as reported to the World Bank/the international donor community in February - may not be correct.
- The March/April SPF/PW MPP/IFC data verification project indicates (and this is a preliminary figure) that the number of Group B, C, D enterprises (excluding all small scale industrial and agro-industrial enterprises) privatized since Jan 1995 may be closer to 6500 - 7000.
- SPF management publicly stated that, while the numbers may be lower than previously officially reported, the SPF will henceforth report only actual, verified (with donor consultant assistance) privatization data. In this regard, the SPF has for the first time permitted its PW MPP consultants to have complete access to the ETAP database in order to assist the SPF in its verification and planning tasks in fulfillment of the Vice Prime Minister's orders.
- During the month of March, the SPF's "temporary acting" Chairman, Mr Bondar, issued an order to the SPF and the RPF's containing specific instructions to implement the 1998 Privatization Program including procedures to (beginning in April) allow the sale of shares for the first time at below nominal/book value based on market demand versus supply in Privatization Certificate (PPC) auctions and all other forms of sale. The order allows all enterprises approved for privatization prior to 1998 to follow the 1997 Program's quotas which provide for higher percentages of sales for PPC's and Compensation Certificates (CC's). The order also requires that, in line with the 1998 Program, state shareholdings are to be limited to only "strategic" enterprises (as defined by the Cabinet of Ministers). For each such enterprise, the relevant branch ministry and the Cabinet of Ministers are to justify to the SPF why the state should retain shares in these enterprises (i.e. why they are "strategic" in terms of the state's interests).
- The PW MPP team developed new PPC auction procedures and forms to allow for the sale of shares below nominal value - based solely on market demand - in PPC auctions beginning in April.
- The SPF developed a plan to sell for cash - via stock exchange sales and tenders - share packages in Ukraine's 300 largest, most attractive, privatizable enterprises in order to generate - at a minimum of nominal value - at least UAH 1 billion in revenues for the state in 1998. PW MPP team analysis indicates that the SPF could today sell for cash available, approved share packages in 200 largest/most attractive (based on previous auction results) enterprises at nominal value and generate more than UAH 1 bil in revenues. This estimate is based on the shares being sold at nominal value. In fact, experience indicates that the enterprises on the list could actually sell shares at multiples over nominal value. Cash auctions and tenders of share packages already approved for sale by the four electric generating companies alone could generate at least 50% to 75% of the total 1998 privatization revenue target set by the GOU and approved by the VR.
- The SPF agreed to utilize the PW MPP team's draft "mass cash" auction procedures which provide for the sale for cash of remaining state shares - in hundreds of enterprises - to the public and financial intermediaries via the Auction Center Network based on demand versus supply (no floor price). (Procedures for cash sales via local stock exchanges and the OTC are already in operation.)

- The State Communications Committee, the management of the telecoms' monopoly - Ukrtelecom - and the Cabinet of Ministers agreed in principle to the PW MPP drafted "Law on the Privatization of Ukraine's Telecommunications Industry". The draft Law provides for the transparent and accelerated privatization of Ukrtelecom, allows foreign strategic investors to acquire majority shareholdings, and provides for the preferential sale of shares via the mass privatization program for certificates to the telecoms' sector's several hundred thousand employees.
- The PW MPP team prepared privatization statistical analyses and a report on the status of privatization of strategic sector enterprises for USAID in preparation for the Gore-Kuchma Commission meetings.
- The team reviewed - and submitted recommendations to USAID and the donor community regarding - potentially negative plans by the management of Khlib Ukrainy and the Ministry of Agro-Industrial Complex to retain large shareholdings by Khlib Ukrainy in the 443 ex-Khlib Ukrainy grain enterprises which are undergoing privatization. The team also recommended to USAID that this issue - along with Khlib Ukrainy's monopolistic practices in agro-equipment leasing, fuel and fertilizer distribution, agro financing and other practices which enhance the company's grip on the grain and related sectors - be raised during the Gore-Kuchma Commission meetings.
- The team prepared a review of the draft Energy Sector Financial Recovery Plan - versus current privatization legislation - for USAID and its energy sector consultants.
- The team reviewed and prepared recommendations on the draft SPF international advisor and tender regulations.
- The team reviewed the draft SPF/Ukrainian Center for Certificate Auctions' (UCCA) 1998 Auction Center Network financing agreement, recommending to the SPF that SPF audit and IT management roles be clearly described. The SPF agreed and also requested that the PW team review the financing proposals versus historical operating requirements.
- The team reviewed - and submitted recommendations to the SPF/Cabinet of Ministers and USAID/the donor community - regarding the potentially very negative consequences which might follow from President Kuchma's decree of March 27 which proposes that all uncollected PPC's be turned over to the State Investment Company ("Derzhinvest") which would then invest the PPC's in auctions, sell the shares thus acquired and use the cash proceeds to provide social benefits to citizens. This is one of the most ludicrous schemes ever proposed by the GOU, is in clear violation of existing privatization legislation (e.g. the state is not allowed to buy shares from state enterprises undergoing privatization), would serve to enhance the role of Derzhinvest and would be unlikely to benefit the public. (If the state wants to raise cash for social benefits, it need only sell shares of state enterprises for cash - no need to go through such a crazy scheme).

Preparation of Enterprises for Privatization

- The regional consulting team, based on orders of the SPF Chairman so authorizing the PW MPP team consultants, spent much of the month engaged in consulting the Regional Property Funds to verify - via checking the SPF's "ETAP" database and hard copy files for each enterprise - which medium/large enterprises might reach 70% to 100% shares sold during the April through September period.

- This project will continue into early April to allow for further investigation of the nearly 2000 enterprises thus far classified by the RPF's as having various "obstacles" preventing their privatization before the end of September. The obstacles range from "non-existent enterprise" to "not operating" to "awaiting Cabinet of Ministers' approval of share allocation plan", etc. Enterprises will be placed in various categories which will then be addressed by blanket orders from the Cabinet of Ministers or the SPF which will allow for the RPF's to offer for sale remaining share packages. (At the same time, the universe of medium/large enterprises might be reduced, eliminating what are essentially bankrupt enterprises.)
- In the case of Agro-Industrial enterprises, the RPF's will be ordered to monitor - on a monthly basis - all AIC enterprises which are conducting preferential share sales to employees and producers. For hundreds of these enterprises, the complex AIC privatization process has resulted in their completing only a portion of preferential share sales. The RPF's will also be ordered to initiate parallel share sales for certificates to the public and cash auctions while preferential sales are being conducted.
- The PW MPP team completed drafting of the Corporate Charter for Dniproenergo, one of Ukraine's four electric power generating companies which has initiated privatization via share sales to employees. The team also consulted Dniproenergo management on the organization and conducting of its first shareholders' meeting (Dniproenergo is the first of the four to hold a shareholders' meeting).. The shareholders' meeting, conducted in March, adopted the Charter which - based on international standards - very strongly supports the rights and interests of shareholders and the responsibilities of and transparent reporting by management and the Board to the shareholders. The meeting also elected a broadly based board of directors including representatives of outside investors, management, the SPF and the Ministry of Energy. Zakhidenergo, another of the four generating companies, has requested similar assistance from the PW MPP enterprise preparation team in the drafting of its corporate charter and the conducting of its first shareholders' meeting.
- The enterprise preparation/regional consulting team conducted a seminar on enterprise valuation and accounting procedures for 15 large enterprises undergoing preparation for privatization in Kyiv on March 4 and completed planning for similar seminars for large enterprises in Donetsk, Dnipropetrovsk, and Zaporhizia in April.
- The team conducted Agro-Industrial privatization training seminars for RPF's and the managers of ex-Khlib Ukrainy enterprises in Volyn and Luhansk regions.
- The team drafted a new "step-by-step" guide for the sale of shares by grain sector and other AIC enterprises for cash through stock exchanges.
- The team prepared briefing materials on AIC and Khlib Ukrainy demonopolization and privatization for the management of the SPF and USAID for the Gore-Kuchma Commission meetings in Washington last week.
- The team completed drafting of a new manual on accounting procedures and regulations for enterprises preparing for privatization.
- The team assisted the RPF's and the SPF in the preparation of 303 share packages - including 100 new enterprises - for the April PPC auction (the first at which shares can be sold below nominal value).

Mass Privatization Web Site/Public Information

- A presentation of the Mass Privatization in Ukraine web site was made to the management of the SPF. In response, SPF management ordered that all tenders, especially those for international strategic investors, should be published (in Ukrainian and English) - when announced by the SPF - on the web site. The Zakhidenergo international tender was published on the web site.
- The SPF continued to provide updated information on the number of enterprises privatized to date for publication on the web site.
- International access to the web site increased with the number of countries accessing the site increasing and number of “hits” reaching 200 per day.
- The PW MPP initiated plans to reorganize and streamline the layout and contents of the web site to make it more “user friendly” and accessible to the international market/potential investors in Ukraine’s privatization program.

Mass Privatization: Information Technology

- Developed revisions to - and began implementation of - the PPC auction programming including auction calculation software to allow for the sale of shares below nominal value.
- Began development of programming for “mass cash” auctions via the Auction Center Network.
- Completed fourth month of training of SPF IT specialists for their assumption of responsibility for certificate auction programming, systems, telecoms/data transfer, and shareholder database maintenance.

Mass Privatization: Audit

- Developed and organized certificate Auction Center Network training program for the audit staff of the SPF. The SPF audit staff failed to participate in the training program. Attempting to obtain SPF management support for such training and skills transfer.
- Worked with UCCA to develop program for joint “spot checks” of Auction Center Network operations.
- Reviewed draft SPF/PW MPP “mass cash” auction procedures and developed extensive proposal to address audit issues raised by the procedures. The proposed audit program for “mass cash” is to be submitted to the SPF for its consideration and implementation (with PW MPP audit team assistance to set-up).
- Worked with PW MPP multi-department team to develop an extensive draft Non-Expendable Property list and disposition proposal for the more than 500 pieces of USAID-owned equipment and software - valued at more than USD 1 million - in use by the Auction Center Network - as well as the USAID-owned furniture in use by the Auction Center Network and the PW MPP team, and the computer equipment used by the PW MPP team.
- Provided audit training as part of the enterprise preparation seminars for enterprises preparing for privatization.

- Begin preparation of the 1997/98 summary audit findings report.

APRIL 1998 PROGRESS REPORT

Political Environment and Mass Privatization

With the election of a new Parliament concluded on March 29, the implications of the election for Ukraine's privatization program became somewhat clearer in April. The consensus (as we gather from our various counterparts) is that:

- While the Communist bloc made significant advances, their gains will be offset by the large number of unaffiliated, business people elected to the Verkhova Rada who will support continuation of the 1998 Privatization Program.
- A significant number of Communist (and Socialist) deputies have vested interests in privatization in their home districts. Their wallets may override their ideological opposition to privatization.
- The experience of the previous Verkhovna Rada (VR) - e.g. Parliament's approval of a very progressive 1998 Privatization Program in February 1998 (despite the dominance of the Communist/Socialist parties) - is an indication that "reactionary" dominance of the VR does not necessarily mean an end to privatization and economic reform.
- The reaction of the GOU (including the Cabinet of Ministers and the State Property Fund) to the elections seems to be "business as usual". The management of the SPF expects that the new VR will implement no radical changes or disruptions to the privatization program and that the current acting SPF Chairman will be approved by the new VR.
- One month after the elections, it remains unclear as to whether the GOU will use its powers during the post-VR elections/pre-Presidential election period to accelerate the privatization program (i.e. complete mass privatization of the universe of 10,000 medium/large enterprises and implement an effective program to sell large share packages of the 200 largest enterprises to strategic investors) and whether any personnel changes in the Cabinet will strengthen the position of those who support such acceleration.

What is clear is that the reformers in the government continue to need the full support of the international donor community. There are specific initiatives for which the international donor community can assist and for which such support can make a real difference as to whether the reforms are actually implemented or die due to lack of broad support within the GOU.

For Ukraine's privatization program, there are a number of initiatives supported by the reformers in April which need international donor encouragement and technical assistance in order to be fulfilled:

- *Agro-Industrial Enterprise Privatization:* Vice Prime Minister Tyhypko supports 100% privatization of all ex-Khlib Ukrainy (KU)/grain monopoly elevators/enterprises. He is opposed by the "agrarian lobby" which includes the management of KU, the Ministry of Agro-Industrial Complex and (apparently) the Prime Minister. They are proposing that the state (with KU management?) should retain 26% shareholdings in all 343 ex-KU grain enterprises (this number excludes the 100 to be fully owned by KU and the 100 already approved for 100% privatization in January).

Such shareholdings would mean that the grain sector monopoly would continue in full force with the agro lobby having direct and indirect influence over Ukraine's strategic grain

sector. After months of debate (and lobbying by KU management and their supporters in the GOU), this issue of retention of shareholdings by the state (or by KU) is still unresolved.

We are working with the Vice Prime Minister's colleagues and the SPF to ensure that any 26% shareholdings retained by the state in 343 ex-KU elevators/grain enterprises not be transferred to KU for management and that these share packages be quickly sold in cash auctions. We are also working with the Anti-Monopoly Commission to convince them that state (or KU) retention of these enterprises is an issue which they can no longer ignore.

- *“Mass/Certificate” auctions versus “Cash” auctions:* The SPF is under severe pressure from the government to generate budget revenues. As a result, the SPF is focusing its attention on expanding means to conduct cash auctions. Plans are being implemented to offer the shares of hundreds of enterprises for cash via local stock exchange sales and via cash auctions through other vehicles including the certificate auction network. *Based on the results of cash auctions via stock markets and cash tenders conducted to date, our analysis clearly indicates that the SPF/GOU strategy will fail.*

For the vast majority of enterprises in which the state retains significant shareholdings, there is no investor interest - no matter what the price. We believe that the SPF/GOU should sell all remaining state shares in 95% of these several hundred enterprises in certificate auctions. The elimination of nominal value/floor pricing for privatization certificate (PPC) auctions - which became effective for the April PPC auction - ensures that all shares offered are sold.

The strategy of the SPF/GOU, we believe, should be: offer all remaining state shares in “non-strategic” enterprises in certificate (PPC and Compensation Certificate auctions) over the next seven months, offer only “leftovers” (i.e. small share packages averaging 5% to 10%) in mass cash auctions via the auction center network with no floor prices (i.e. the highest bidder wins - no matter what the price offered).

Cash auctions of large share packages must be limited to Ukraine's 200 largest, most promising, most “strategic” enterprises. The new management of the SPF is eager to complete the drafting and implementation of new international advisor and tender regulations for these enterprises. The Cabinet of Ministers and the new acting SPF Chairman have ordered that such new advisor and tender regulations should be fully adopted before the end of May.

- *Privatization of the Universe of Medium/Large Enterprises by the end of 1998:* International encouragement is also required to support and ensure that the SPF/Cabinet of Ministers/GOU implement their plans for the completion of the mass privatization program - nearly 10,000 medium/large enterprises 70%+ privatized since January 1995 - by early 1999. The SPF has prepared an overall plan for the remaining 2200 enterprises (out of 10,000) to be privatized between now and late 1998/early 1999 (i.e., 7600 + 2200 = 9800/completion of the mass privatization program).

Nearly 1000 of the 2200 enterprises planned are “stuck” in the privatization pipeline. For various reasons, these partially privatized enterprises face one or more of several generic obstacles preventing complete privatization. Most of these obstacles can be addressed by the SPF/Cabinet of Ministers and these nearly 1000 enterprises can be completely privatized by the end of this year/early 1999.

Planning - and implementation of plans - to completely privatize these 1000 enterprises would allow the SPF to fulfill the Vice Prime Minister's Order to privatize 9500 medium large enterprises by the end of September - in fulfillment of commitments made to the World Bank and IMF.

- *Completion of the Mass Privatization Program: Creation of Plans versus Implementation of Plans.* While the SPF and the Regional Property Fund branches are to be congratulated for

developing (with PW MPP and IFC assistance) a list of 2200 enterprises which are to be planned for month-by-month privatization (>70% shares sold) between now and early 1999 (i.e., a plan to complete the mass privatization program), the plans will remain a pipedream unless the SPF actually begins to implement its plans this month:

1. *Mass cash (and stock exchange) auctions of hundreds of enterprises will only delay completion of the mass privatization program.* The SPF is planning to offer shares of more than 2000 enterprises in mass cash auctions via the auction center network beginning in June - along with increased offerings on local stock exchanges. Because shares will be sold to the highest bidder - with no floor price - the SPF is confident that all shares offered will be sold. However, based upon the SPF's experience in offering shares on stock exchanges (where - even at less than book value - shares have generally attracted no interest), there are many who believe that the mass cash auctions will fail.
2. *With the exception of share packages in 200 strategic enterprises, all "70%+" share packages (i.e., those share packages which, if sold, will result in the enterprise being privatized/70%+ sold) should be sold in PPC/CC auctions.* Only small packages of leftover shares (5% - 10%) should be offered in "mass cash" auctions.
3. *Regional Property Fund offices (RPF's) which are submitting their month-by-month plans to complete the mass privatization program are proposing that (in order to reach 70%+ shares sold) the SPF Central Office should offer and sell share packages in mass cash and stock exchange auctions.* The problem with such planning is that the responsibility for reaching 70%+ shares sold is transferred from the RPF's to the SPF Central Office. In other words, the RPF's can "pass the buck" in terms of implementing their own plans - with the result that hundreds of enterprises are not privatized. At the same time, the SPF must urgently plan for the completion of privatization of nearly 400 largest enterprises for which the SPF Headquarters is at fault for delaying completion of privatization.
4. *In terms of reaching the World Bank/IMF conditionalities of 9500 enterprises privatized by the end of September - and completion of the mass privatization program by early 1999 - Certificate Auctions remain the key vehicle.* Over the past several months, 100 to 125 medium/large enterprises have reached 70% to 100% privatization via PPC and CC auctions. These enterprises privatized via Certificate Auctions represent 90% of the total number of medium/large enterprises privatized (70% sold) by the SPF/GOU each month. **POOR PLANNING FOR CERTIFICATE AUCTIONS REMAINS THE BIGGEST OBSTACLE TO COMPLETION OF THE MASS PRIVATIZATION PROGRAM, AN OBSTACLE WHICH THE SPF CAN ADDRESS - BUT HAS REFUSED TO ADDRESS - FOR THE PAST 3 YEARS.**

As the Price Waterhouse USAID Mass Privatization Project team nears the end of its 3 ½ years of work to consult the GOU on completion of its most important, first stage economic reform program, we would like to propose two immediate areas for which continued USAID/international donor support could prove crucial. (These proposals exclude the many longer term issues - enterprise restructuring, bankruptcy/liquidation, corporate governance, et al - which need addressing.)

Two areas which could significantly benefit from additional international technical assistance (for which the SPF/GOU badly need assistance and advice):

- (1) *Agro-Industrial (AIC) Sector Demonopolization/Privatization:* Because of the specialized law/regulations governing privatization of the agro-industrial sector, including the grain sector, the process of privatization is much more complex and can require many more months than privatization of the industrial sector. Which means that large, agro-industrial sector enterprise privatization cannot be completed until - at best - mid-1999. We are writing the manuals, providing the training (to large AIC/KU enterprises, helping write the privatization acceleration regulations and procedures, are working with the Cabinet of Ministers to ensure 100% privatization of most AIC monopolies, and are the providing “grassroots” consulting to assist large AIC enterprises in all regions of Ukraine in initiation, acceleration and completion of the privatization process. But this consulting work - which is the only international technical assistance being provided in support of the privatization of Ukraine’s largest AIC enterprises - is to end at the conclusion of our current contract in September.

- (2) *Ukraine Privatization/Investment Web Site:* We have been developing and maintaining the “Ukraine Mass Privatization” Web Site for the SPF/GOU for the past several months. The Web Site - which is readable in both English and Ukrainian - contains 13 megabytes of data, the most comprehensive of all Ukrainian Web Sites. The Web Site is now linked with all major emerging markets/privatization sites including the World Bank’s emerging markets and privatization web sites. More than 200 “hits” per day are received from potential international investors and other interested parties. The SPF does not have sufficient resources/experience - in terms of experience in presentation of information to an international investor audience, the technical aspects of maintaining a major web site and English language skills - to run the web site beyond September. Maintenance and expansion of the SPF/GOU bilingual privatization and investment web site is a critical and highly cost-effective tool by which Ukraine can communicate to the international investor community (and is now the on-going vehicle which the SPF/GOU have to reach the international target audience). Support to assist and train the GOU to run the web site will be required - and would be a small but effective investment in technical assistance funds.

Despite the political uncertainties, a number of new initiatives were undertaken by the Mass Privatization project team during the month of April in support of State Property Fund/Cabinet of Ministers/GOU efforts to accelerate and complete the mass privatization program:

Privatization Strategy/Policy Consulting and Data Analysis

- The SPF proposed to redefine the universe of medium and large enterprises in order to meet the World Bank EDAL II and IMF EFF conditionalities. The SPF proposed to redefine the universe to include all enterprises (no matter what the size of fixed assets) which are privatized by mass privatization (non-small scale privatization procedures). This would permit the SPF to significantly increase the universe - and thus to meet WB/IMF targets - without actually accelerating the program.

- We reviewed and discussed the proposal with representatives of the SPF, the Cabinet of Ministers and the Ministry of Economy and with USAID and the World Bank. We advised the SPF as follows: 7600 enterprises are verified as privatized between January 1995 and the end of April 1998, the “9500 by late 1998” target can be met without redefining the universe, and we agree that the definition of medium/large enterprises is > UAH 1 million in fixed assets.

- The PW and IFC teams assisted the SPF and all regional branches of the SPF to verify and plan for the month-by-month sale (>70%) of 1200 enterprises by the end of September (i.e., 7600 + 1200 = 8800).
- To this total will be added up to 1000 additional enterprises which are partially privatized but face various obstacles preventing complete privatization. The verification and planning of the sale of these enterprises will be concluded in May. (i.e., 7600 + 1200 + 1000 = @ 9800 privatized by late 1998).
- The regulation allowing for the sale of shares below nominal value (i.e. no floor price) in Privatization Certificate Auctions - and all types of share sales by the SPF - was approved and registered by the Ministry of Justice and implemented.
- Regulations were approved to implement “mass cash” auctions of (leftover?) shares via the auction center network beginning in June.
- Monthly Work Plans were drafted and presented to the SPF for the completion of Mass Privatization/Certificate Auctions by the end of 1998.
- Drafted proposals for the SPF, Ministry of Economy and the Cabinet of Ministers to meet WB and IMF grain sector/Khlib Ukrainy privatization targets.
- Khlib Ukrainy management proposed to the Cabinet of Ministers modifications to Cabinet of Ministers’ Khlib Ukrainy privatization resolution #1218, proposing that the state retain 26% of shares in 340 grain elevators. We proposed legal arguments to the Cabinet of Ministers as to why the proposal should be rejected.
- We proposed to the international donors - and the SPF/GOU - arguments as to why the President’s decree on establishing a state fund which will collect and invest all uncollected Compensation Certificates as of the end of CC distribution on June 30 is a “disaster”. (This decree must be killed - but will come into effect if not rejected by the VR by the end of May.)
- We reviewed and proposed to the SPF arguments as to why the draft Presidential Decree on converting the auction center network into a “Unified National Stock Exchange System” is another “disaster” which must be rejected by other stock exchanges and the securities industry.
- Drafted Corporate Charter for Dniproenergo (one of Ukraine’s big four generating companies undergoing privatization) which was adopted during the company’s first shareholders’ meeting, organized with our assistance. Similar consulting assistance provided to Zakhidenergo.
- The Prime Minister signed-off on our draft of the Law on Privatization of Ukrtelecom. The Law provides for standard privatization procedures including the initial sale of shares to 400,000 employees (for 15% to 20% of shares) of the telecoms industry and post office on a preferential basis (in the fall of 1998?).
- We assisted the SPF to review and adopt the draft “Tender for Authorized Persons Regulation” (which is to govern the tendering for international advisors to advise on the sale of share packages of strategic enterprises to international investors).

Preparation of Enterprises for Privatization

- Conducted privatization training seminars for 50 Khib Ukrainy elevators in three oblasts.
- Prepared and distributed a new manual on KU cash tender procedures to KU managers nationwide.
- Participated in an investors' seminar on elevator privatization hosted by the Ministry of Agro-Industrial Complex and lobbied participants/the Cabinet of Ministers to sell all state shares in all but 100 KU elevators.
- Conducted enterprise valuation and accounting training (for preparation for privatization) seminars in Donetsk, Dnipropetrovsk and Zaporhizhia.
- Provided direct, issue-specific enterprise preparation consulting to 18 KU elevators and 12 large ("Group D") industrial enterprises.
- Verified the fixed assets book value of enterprises in 14 oblasts. Drafted recommendations to the SPF on means to resolve obstacles which have prevented the inclusion of 1000 enterprises in the 1998 share sales plan.
- Completed the first draft of the "Red October" enterprise privatization case study.

Mass Privatization Web Site/Public Information

- Completed "reconstruction" and re-launch of the web site which is now more "user friendly" and allows for better ease of access to data and information.
- Established web site links with the World Bank's Emerging Markets and Privatization web sites - providing access to the world's largest international companies and emerging markets investors.
- Began posting of the SPF's tender announcements.
- Prepared web site package for presentation by the SPF to the EBRD meeting.
- Received 200 "hits" per day to the web site from parties in 27 countries.

Mass Privatization/Information Technology

- Completed the first stage - four months - of training of six SPF IT managers to assume responsibility for managing the nationwide certificate auction and shareholders database software development and maintenance functions.
- Initiated joint SPF/PW maintenance of all auction systems (except auction calculation software - which SPF IT managers are not yet ready to manage).
- Completed development and testing of the new Privatization Certificate auction - below nominal value - auction calculation software.
- Began development of the "mass cash" auction software with SPF IT specialists.

Mass Privatization/Audit

- Met with SPF, auction center and National Savings Bank officials to review proposed “mass cash” auction procedures and to recommend appropriate audit procedures for such auctions to be conducted via the auction center network.
- Met with auction center network officials and commercial bank officials to propose mass cash auction settlement procedures.
- Began drafting for the SPF and the management of the auction center network audit procedures for the cancellation and destruction of PPC and CC certificates when distribution ends on June 30.
- Prepared PW MPP USAID owned equipment inventory.
- Began preparation of 1997 and 1998 Summary Audit Findings Report for delivery to the SPF, GOU and USAID.
- Prepared recommendations to the SPF regarding their 100% funding of the auction center network in 1998.
- Provided large enterprise training in valuation and accounting issues related to preparation for privatization.

Other developments:

- Began preparation for ending the PW MPP Audit function as of May 31 and for reducing the PW MPP IT team to four consultants on May 31.
- In June, all enterprise preparation consulting by the PW MPP team is to be 100% devoted to Agro-Industrial/Khlib Ukrainy enterprises.
- All regional consulting will be devoted to AIC/KU enterprises and to preparation and planning of 2000+ enterprises in order to reach 9500+ enterprises privatized by the fall of 1998.
- No new post-1998 privatization initiatives - except agro-industrial demonopolization/privatization will be conducted by the PW MPP team.
- We are planning for the reduction in expatriate consultant staffing to two people beginning June 1.

MAY 1998 PROGRESS REPORT

The progress to date of the Government of Ukraine/State Property Fund in meeting the World Bank's EDAL II loan conditionalities (as agreed during negotiations in February of this year) and the IMF's draft EFF loan conditionalities is as follows.

Negative News

The Government/State Property Fund are failing (because of their focus on cash sales - when there is little cash for investment in the local economy) to meet international donor conditionalities to complete the mass privatization of Ukraine's 10,000 medium/large enterprises by the end of this year, to more rapidly accelerate privatization of the Agro-Industrial sector, and to begin using new, international standard tender procedures for the hiring of advisors for the sale of large share packages in Ukraine's 25 to 50 largest and most attractive industrial enterprises.

Good News

However, the GOU/SPF mass privatization program has been very successful:

- * in exceeding the donors' 100% privatization goals (i.e., in 100% privatizing each of 4720 medium/large enterprises to date),
- * in privatizing the country's 200 largest "giant" enterprises (63 giants have each been 40%+ privatized to date including 26 giants which are 100% privatized),
- * in initiating privatization of Ukraine's largest grain elevator and grain processing enterprises (a process which only began in the fall of 1997) - 122 such enterprises have begun share sales with 36 enterprises at least 70% sold to date.

World Bank Conditionalities versus Results to Date

8500 Medium/Large Enterprises (MLE) to be 70% privatized since Jan 1, 1995 by summer of 1998 (9500 by fall 1998):

- * 7600 MLE 70%+ privatized to date.

4250 MLE to be 100% privatized by summer of 1998 (4750 by fall 1998)

- * 4720 MLE 100% privatized to date.

60 "giant" enterprises (giant enterprises are Ukraine's very largest, defined by the GOU as those with more than UAH 170 million in fixed assets) - out of a universe of 200 privatizable giants - are to each reach 40%+ privatized by summer of 1998 (100 by fall 1998):

- * 63 "giants" have each been 40%+ privatized to date,
- * including 42 giant enterprises which are 70%+ privatized,
- * including 26 giant enterprises which are 100% privatized.

300 grain marketing and distribution (GMAD) enterprises to begin share sales by summer 1998 (450 by fall 1998):

- * 122 GMAD's have begun share sales to date (including 100 ex-Khlib Ukrainy grain elevators).

60 GMAD's to be 70%+ privatized by summer 1998 (100 by fall 1998):

- * 36 GMAD's (including 20 ex-Khlib Ukrainy grain elevators) have reached 70%+ shares sold to date.

Complete the drafting of and officially approve new, transparent, international standard regulations to conduct tenders for (international) advisors and tenders for the sale of large share packages in strategic enterprises to (international) investors by the summer of 1998:

- * Donor/consultant and SPF drafting of the new “Regulation on the Selection by Tender of Authorized Persons to Assist in the Sales of Shares through Competitive Methods” and the “Regulation on Procedures for the Preparation, Organization and Conducting of Open Sales (Tenders)” was completed this week, the Regulations were approved by the management of the State Property Fund and sent to the Ministry of Justice for review and registration. These new procedures will replace the ill-conceived tender regulations hastily prepared by the SPF in December.

Initiate three international strategic enterprise tenders by the summer of 1998 (10 by the fall of 1998):

Two tenders for international advisors (using the old procedures) have been conducted to date for the sale of large share packages in two major electric generating companies, Donbasenergo and Tsentrenergo. Negotiations between the advisors and the SPF over contract terms continue.

Negative News/USAID and International Donor intervention required before the end of June:

Privatization Certificate (PPC) and Compensation Certificate (CC) distribution to the public ends on June 30. The State plans to confiscate/invest Compensation Certificates.

On June 5, 1998, the Cabinet of Ministers issued Resolution #809, signed by the Prime Minister, which appoints the 100% state-owned investment companies - “Derzhinvest” and the newly-created “FinProm” - to gather and to invest all (72% of total) Compensation Certificates not collected by the public as of June 30.

PPC (90% collected to date) and CC (28% distributed to date) distribution to the public ends on June 30, 1998. PPC and CC auctions end on December 31, 1998. (As required by the 1998 Privatization Program adopted by the Parliament).

The President issued (in March), the Parliament did not overturn, and the Prime Minister signed into law this week a Decree which could well “sabotage” the mass privatization/certificate auction program:

The Decree/Law and the Cabinet of Ministers supporting resolution provide for the following:

- All Compensation Certificates (72% of the total available) not collected as of July 1 (when CC distribution to the public ends) are to be accounted for and turned over to DerzhInvest - state-owned investment holding company - which is to receive all CC's which were to be distributed via Oranta, the state insurance company) and FinProm - a new state-owned investment holding company - (which is to receive all CC's which were to be distributed via Sberbank, the state savings bank).
- The SPF is to increase enterprise share allocation quotas for CC auctions.
- Beginning with the August 15 CC auction, the shares of 399 of Ukraine’s most attractive enterprises (large Group D enterprises belonging to the SPF's Central Office - including many energos) are to be offered in the final 5 CC auctions.
- The concept is that Derzhinvest and FinProm will then sell shares acquired for cash and send the cash to the state budget and to support domestic manufacturers.

- The new Law is clearly problematic: Shares in state-owned enterprises can be sold now for cash for the budget - no need for another (state) intermediary to collect and invest CC's and sell shares.
- The new Law also violates privatization legislation: The Law on Privatization prohibits enterprises with more than 25% state ownership from buying shares in privatizing enterprises. According to the 1998 Privatization Program, all uncollected CC's are to be cancelled and destroyed following the distribution (June 30) deadline. The President has no right to issue decrees on issues already regulated (by the Law on Privatization and 1998 Privatization Program). Finally, the new Law violates the Constitution: The state cannot take away an individual's property rights, i.e. citizens are entitled to collect their CC's - not the state on behalf of citizens.
- In addition to its dubious legal status, the new Law: Means that any shares "privatized" via DerzhInvest and FinProm should not be included in the donors' privatization numbers as reported by the SPF.
- The decree/law transfers to DerzhInvest and FinProm the privatization authority of the SPF. This "transfer" would give DerzhInvest and FinProm the means to sell CC's or shares by any means - to insiders on either a negotiated or auction basis, i.e. it would provide them with the means for more "flexible" share sales mechanisms, less scrutiny by the prosecutors and Rada and thus (as they hope) more revenue generation for the state budget.

USAID funded the printing and distribution of Compensation Certificates by the GOU/SPF. And USAID funded the technical assistance to develop and implement the vehicles by which the public could invest their CC's.

The leadership of the GOU (as opposed to the leadership of other FSU countries - Russia, Moldova, Kyrgyzstan - which successfully concluded voucher mass privatization programs) has never publicly supported the Compensation Certificate privatization program. Despite the agreements of the President and Cabinet of Ministers to promote the Compensation Certificate auction program in 1995/6, the Government has never publicly supported the CC distribution and auction program since its introduction in 1996.

Given USAID's funding for the printing of the CC's and the technical assistance over the past 3 years to implement their usage in CC auctions, USAID and the US government are completely justified in taking a strong stand in opposition to the President's/Cabinet of Ministers' Decree which support a state take-over of the CC collection and investment program. Outside of USAID's investment in the CC privatization auction program, the confiscation by the state of uncollected CC's is a clear violation of the objectives of the mass privatization/CC auction program: to compensate citizens for lost savings and to rapidly accelerate the mass privatization program through the auctioning of shares based on demand/supply pricing (no minimum/floor prices).

Following are highlights of the key external events which impacted Ukraine's privatization program and the key outputs for the month, listed by team:

Privatization Strategy/Policy Consulting and Data Analysis

Key Events and Outputs

Government/State Property Fund issues

- * The Presidential Decree on "Additional Measures to Compensate Losses in the Peoples' Accounts at the Saving Bank" came into force. The Decree allows the state to collect all

Compensation Certificates - not collected by the public as of the end of distribution on July 1 - and to utilize them to purchase shares in "blue chip" enterprise shares offered in CC auction during the second half of 1998. Our legal team prepared a legal analysis of the Decree which has been distributed to counterparts in the State Property Fund (SPF) and the Cabinet of Ministers (Cab Min). The analysis confirms that the Decree is in violation of the Law on Privatization, the 1998 Privatization Program and the Constitution. We are promoting the cancellation of this Decree via counterparts and donor organizations.

- * The Cab Min, on June 8, issued Resolution #809 which appoints the state investment companies, "Derzhinvest" and "Finprominvest" as the authorized agencies to collect and invest the CC's.
- * A new acting Chairman of the SPF (the former first deputy chairman) has been appointed for the duration of the former acting chairman's absence due to illness. The newly appointed acting Chairman refuses to meet USAID and PW representatives to discuss the key issues of mass privatization strategy despite the daily requests over the past month for such a meeting.
- * Mass privatization/certificate auctions continue to be conducted - month-by-month - with no clear strategy, with no planning (despite our two months of work to assist the SPF to develop a plan to meet donor conditionalities) and with poor overall results. There is still no SPF "plan graphic" for the sale of share packages of 2200 enterprises by year end - which would allow the GOU to reach 9500 enterprises sold by late 1998.

Certificate auctions

- * Amendments to the regulation for the calculation of certificate auction results allowing for the sale of shares below nominal value was registered by the Ministry of Justice. The results of the 39th (April) privatization certificate (PPC) auction has been calculated using the newly approved procedures. The results will be officially announced as soon as the Cab Min approves necessary amendments to the general auction regulation.
- * The SPF's "plan graphic" for the July PPC auction calls for the share packages of 200 enterprises to be offered with 100 to reach 70% sold (nominal value/floor prices no longer apply to PPC auctions - thus more enterprises can reach 70%+ sold via both PPC and Compensation Certificate auctions). However, the SPF gave the Regional Property Fund offices only one day to prepare following the issuance of the plan.
- * In the June PPC auction, only 230 enterprises offered shares with only 30 medium/large enterprises which might reach 70%+ sold.
- * Only 19 medium/large enterprises will reach 70%+ sold in the July CC auction.

Cash sales

- * The Regulation for specialized cash auctions ("mass cash auctions") have been approved and registered by the Ministry of Justice.
- * The first auction has been scheduled for July 1 - 10. Shares of 102 companies, including 2 electric power companies (Kirovograd Oblenergo and Sevastopol Oblenergo) will be offered for sale for cash via the Auction Center Network with no floor price.
- * In order to ensure as transparent and effective auctions as possible, we assumed the key role in drafting the regulations, procedures and software to conduct "mass cash" auctions, although not all recommendations of PW consultants were accepted. The PW legal team has provided legal analysis of the agreement between the UCCA and the auction servicing bank, which in our opinion, does not correspond to the auction regulations and does not provide for adequate SPF controls over the auction cash proceeds. These concerns have been expressed to both ACN management and the SPF.

Tender regulation

- * The regulation for the tender selection of privatization advisors for the sale of share packages of strategic enterprises has been drafted and agreed by the donor/consultant/SPF working group,

signed by the SPF and is now being registered by the Ministry of Justice. The document is self sufficient as it contains all procedures necessary to conduct tenders without drafting additional instructions.

- * The drafting of the regulation conducting tenders for the sale of strategic enterprise share packages has also been completed. The proposed document clarifies the issues of bid guarantees, the winning bidder selection process and the contract signing procedures. The draft is being reviewed by the Anti-Monopoly Committee and the Securities Commission.

Legal advisory work

- * At the request of the USAID-funded “Rule of Law “ foundation, PW legal advisors took part in the seminar conducted under the auspices of the Supreme Arbitration Court of Ukraine for the training of judges on privatization-related disputes and lawsuits.
- * Legal analyses of the Presidential Decree on Compensation, the draft amendment to the Cab Min Resolution 1218 on Khib Ukrainy reorganization, cash sales procedures and banking arrangements for “mass cash” auctions and Anti-Monopoly Committee functions were completed and distributed to SPF and Cab Min counterparts.

Strategic enterprise privatization

- * Participating - as the privatization advisors - in the Energy Sector Financial Recovery consultants working group. However, awaiting introductions to appropriate Ministry of Energy (and SPF) counterparts to assist in draft model Contract for the Management of State Shares.
- * Advise the State Communications Committee to complete the final draft of the Ukrtelecom Privatization Law to be presented to the Cab Min and reviewed by the ministries (SPF, Ministry of Finance, Economy, etc.).
- * Advised Zakhid Energo (one of Ukraine’s four thermal electric power generating companies) senior management on the drafting of their corporate charter and documents to govern the first shareholders meeting.

Enterprise Preparation Methodology

- * A new draft “Asset Valuation Methodology” was approved by the SPF sent to the Cab Min for review and final approval. The draft has several significant flaws, including a proposal to index (increase by 7 to 8 times) statutory capital (i.e. nominal value of shares to be sold) of enterprises being privatized. PW is now advising the Cab Min to revise the draft in order to correct the flaws (indexation has been taken out of the draft) and promote share sales starting prices close to real market value, including prices below nominal value.

Privatization Data Analysis

- * Designed and launched new databases (“Energos”, “Khib Ukrainy”, “PFTS”, “Stock Exchange sales”, “Tenders”) and prepare analyses which were presented to counterparts and PW MPP teams leaders. These are the first databases which provide the international donor and investor community - via the privatization Web Site - with up to date information on the status of privatization of strategic sectors and the status of share offerings by the SPF on local securities markets.
- * In April the SPF offered for sale via various local stock exchanges 123 share packages. There was some demand for 38 (30%) of the enterprises which were partially or fully sold. Nominal value of these attractive shares was UAH 9 million. The other 85 share packages are to be re-offered by the SPF which failed to attract any bids in the first round.
- * In May the SPF offered for sale via various local stock exchanges 219 share packages. There was some demand for 19 (8.7%) and these packages were partially or fully sold. Nominal value of these attractive shares was UAH 1.2 million. The other 200 share packages are to be re-offered by the SPF which failed to attract any bids in the first round.

- * In June the SPF will offer for sale via local stock exchanges 466 share packages.
- * The number of share packages offered for cash sale via stock exchanges is growing rapidly month by month. However, the number of share packages sold each month and the depth of share sales is declining.
- * Our estimation is that roughly 200 enterprises per month would reach 70% sold if all share packages offered on stock exchanges were sold. However, recent trends and market conditions indicate that only 10% +/- of this number - or 20 enterprises per month - will be privatized (reach 70% sold) through late 1998 via stock exchange sales.

Privatization cash revenues (in UAH thousands) generated for the state budget by the SPF over the past 6 weeks:

week #	14	15	16	17	18	19	Total	% vs Total
Stock Exchanges	9,978	3,345	152	1,990	2,124	7,500	25,089	39.1%
Tenders				12,158			12,158	18.9%
International Relations Dept (sales of Ukrainian state properties in the FSU)			8,935	4,087			13,022	20.3%
Certificate auction department *	178	260	5,614	45	99	33	6,229	9.7%
Small scale				473			473	0.7%
Regional Property Fund offices (all sources)	506	789	1,464	1,367	796	2,328	7,250	11.3%
Total	10,662	4,394	16,165	20,120	3,019	9,861	64,221	100.0%

(*) Cash from
Preferential Sales

- * Based on Ministry of Statistics, SPF, and Cab Min data, we identified 118 Khib Ukrainy and ex- KU elevators which are leased enterprises. Which means that these enterprises can be privatized very quickly. The lessees can overnight convert their lease holdings into shares. We are advising such enterprises on the means to do so.
- * Prepared new SPF plan graphic for the preparation for privatization (per Order # 859) of the 1004 new medium/large enterprises to begin share sales in 1998 per the 1998 Program.
- * Advised the SPF on the preparation of materials and presentations for the EBRD's Annual Meeting in Kyiv in May.
- * Prepared an analysis of the very largest and most attractive Ukrainian industrial enterprises based on the Cab Min's list of "strategic" enterprises, the Anti-Monopoly Commission's list of "Monopolists", the "Top 200 1997" and the "Top 200 1998" lists prepared by the *Investment Gazette* and Deloitte & Touche, and the official list of the GOU's "giant" enterprises.

Agro-Industrial Complex (AIC) Consulting Team Key Outputs::

- * PW AIC specialists providing AIC/Khlib Ukrainy issues-related consulted on a daily basis to the Cabinet of Ministers and the Ministry of AIC, helped to conduct and gave presentations in five GOU, donor and AIC private sector privatization, AIC reform and investment seminars held during the month.
- * Several PW AIC consultants were approached to join the new, donor sponsored Inter-Ministerial Commission for Agrarian Reform.
- * PW Khlib Ukrainy training seminars and enterprise consulting resulted in the SPF and its regional branches agreeing to offer grain elevator share packages in tenders at starting prices close to nominal/book value.
- * PW AIC consultants assisted the Odesa Regional Property Fund (RPF) with Ukraine's first ex-Khlib Ukrainy elevator tenders. Of the six elevators offered for sale, only two received bids (both of which were from “business associations” established by the employees of the enterprises). Terms for the four unsuccessful tenders in Odesa were revised and new tenders for these enterprises announced on June 3 with starting prices greatly reduced/close to nominal value. Tenders for 19 additional ex-KU elevators (from Odesa and Zaporizhe) continue.
- * PW AIC consultants provided assistance in statutory document preparation, inventorization, valuation, share registration, free transfer of shares, etc. to 43 elevators in the six most prime regions of Ukraine.
- * The AIC consulting team delivered elevator privatization seminars in Odesa (May 5) and Chernivtsi (May 21) and made preparations for upcoming seminars in Lviv (June 10th), Kharkiv (June 17 -- together with IFC), Kherson, Mykolaev and Lugansk. These methodological seminars now include regional representatives from the Anti-Monopoly Committee and the Securities Commission, as well as Khlib Ukrainy and the oblast administration. The latest round of seminars focused on the share sales process, with special emphasis on share sales via tender.

Regional Enterprise Preparation (EP) Consulting Team Key Outputs

- * Regional consultants prepared 443 enterprise packages for certificate auctions (including 183 new enterprises) and 140 packages for the first “mass cash” auction.
- * Consultants ended direct assistance to 26 large industrial enterprises and re-focused EP consulting activities exclusively on ex-KU enterprises. The Kyiv oblast regional consulting team, for example, will begin in June providing EP assistance to 23 ex-KU enterprises in Vinnitsa oblast.
- * Kyiv-based EP consultants provided assistance on inventory and asset valuation to the largest, Group D, SPF Central Office enterprises in Zakarpatya (May 4-8), Mikolaev (May 12-15), and Khmelnytsky (May 19-22).

Ukraine Privatization/Investment Web Site

- * Prepared and launched on web site announcements on 17 enterprises offered for commercial/non-commercial tenders.
- * Launched on the web site all new policy and procedures adopted during the month.
- * Delivered information on Ukraine’s privatization program to investors world-wide via the Multilateral Investment Guarantee Agency of the World Bank Group (MIGA), who launched the Privatization Link (PLink) project.
- * In early May, at request of the management of the SPF, we prepared a visual presentation on the Ukraine Privatization Web Site for the President and his Investment Advisory Committee.
- * Obtained from the SPF and updated the list of enterprises privatized by more than 70% since 1992.
- * Updated the list of enterprises which have completed certificate auctions since January 1995.

- * During May, the number of “hits” to the “Ukrmassp” Web Site exceeded 300 per day, making the site one of the most active of all Ukraine web sites.

MPP/Information Technology Team

- Completed development and testing of the regional part of the mass cash auction software, transferred it to SPF IT specialists for detailed studying and testing.
- Began development of the mass cash auction data consolidation and verification software for the UCCA/auction center network.
- Provided training to Regional Auction Center managers on the regional mass cash auction software.
- Began preparation of the manual on technology of data entry for Regional Auction Center managers and operators.
- Completed the training of six SPF IT managers to assume responsibility for managing the nationwide certificate auction and shareholders database software development and maintenance functions.
- Continued joint SPF/PW maintenance of all auction systems (except auction calculation software).
- Submitted new Privatization Certificate auction - below nominal value - auction calculation software to the UCCA.

MPP/Audit Team

- * The PW MPP Audit Team concluded, per task order requirements, the certificate auction audit program on May 31.
- * The team presented a nearly 100 page final report to USAID (verbally) and to the management of the SPF (in writing) which included reports on key audit findings and recommendations based on the audits conducted over the past 3 ½ years, recommendations on PPC and CC certificate cancellation procedures, recommendations on mass cash auction procedures, recommendations on financial controls/reporting of GOU/SPF funding of the Auction Center Network, and a final audit report on the inventory of USAID-owned equipment utilized by the Auction Center Network.
- * Although Auction Center Network audit staff actively participated in PW audit training programs and have thus been well-trained to carry-on with certificate auction audit tasks, the management of the SPF refused - for 3 ½ years - to agree to our numerous proposals to train SPF audit staff to assume the PW audit function through training seminars and joint audits.

JUNE 1998 PROGRESS REPORT

Highlights

- ◇ State Property Fund/Government of Ukraine meet World Bank EDAL II Tranche 1 Loan Conditionality: The World Bank delegation from Washington, during meetings with the management of the State Property Fund (SPF) on June 25 received confirmation (verified by us) that the SPF had met or exceeded the Tranche 1 conditionalities (see below) for the Bank's \$300 million EDAL II loan.
- ◇ International Tender Regulations Adopted: The Regulation for the Selection via Tender of (international) Advisors to conduct tenders for the sale of large share packages of strategic enterprises and the related Regulation for Conducting Tenders for the sale of such share packages were registered by the Ministry of Justice on July 3, 1998. These Regulations incorporate the proposals of the donors and their consultants and provide Ukraine with transparent and international standard tender procedures. The tender for advisors regulation excludes all up-front, "bridge" loan financing requirements and includes a clause allowing the State Property Fund to utilize the assistance of advisors selected by international donor organizations.
- ◇ "Mass Cash" Auction Preparations Completed: We completed the drafting of all regulations and procedures and the development of the software and related training materials which have allowed the SPF and the Auction Center Network to begin Ukraine's first "mass cash" auction for the sale of remaining state share packages in hundreds of enterprises - with packages sold to the highest bidder (the minimum bid for one share package is only UAH 10).
- ◇ The Parliament voted to extend - *indefinitely (no end date)* - Privatization Certificate (90% distributed to date) and Compensation Certificate (28% distributed to date) distribution to the public

Critical Issues

As the Price Waterhouse/USAID Mass Privatization Project nears conclusion in the fall, we believe it to be a good time to consider the following three issues:

1. Mass privatization/certificate auctions and their role in the near completion of the transfer of the ownership of Ukraine's medium and large industrial enterprises from the state to the private sector, the first stage of Ukraine's industrial restructuring and reform program.
2. Although the State Property Fund has recently met the World Bank's EDAL II Tranche 1 privatization conditionalities, the Government of Ukraine may be unable - given recent developments - to translate this significant accomplishment into the accelerated completion of the Tranche 2 and 3 conditionalities.
3. With the conclusion of the USAID Mass Privatization Project, the Government of Ukraine will require additional donor technical assistance through mid-1999 if Ukraine's privatization program (particularly for its largest and most important enterprises) is to be successfully and fully completed and if the program is to serve as the foundation for the transparent attraction of

significant international strategic investment, the demonopolization of the agro-industrial sector and the rapid development of the country's capital market.

Mass Privatization/Certificate Auctions:

The "Locomotive" for Ukraine's Privatization Program

- * As of the end of 1995, only 727 medium/large enterprises were reported by the State Property Fund as having been privatized (70%+ sold).
 - * As of mid-1996, only 1800 enterprises were reported privatized - with only 11% of the shares having been sold for certificates (in preferential sales to employees and in public auctions) via the mass privatization program.
 - * As of mid-June 1998, 7684 medium/large enterprises had each been 70% to 100% sold (including 4777 enterprises 100% privatized) since January 1995.
 - * Approximately 50% of the shares of these 7684 privatized enterprises were sold for certificates via the mass privatization program.
 - * More than 10 times the number of medium/large enterprises have been privatized as of mid-1998 versus the end of 1995.
 - * The percentage of shares sold for certificates increased from 11% of total shares sold - to 50% of total shares sold - over the past two years.
 - * According to the latest data from the SPF, as of April 1, 1998, financial intermediaries had acquired 28 million Privatization Certificates (PPC's) from the public and had invested 27.2 million for shares of enterprises offered in PPC auctions. Thus, financial intermediaries have only 800,000 uninvested PPC's in their portfolios.
 - * The financial intermediaries have played a leading role in serving as a major vehicle for investment by more than 28 million citizens (out of the 46 million who have collected their PPC's) in the share auctions. This is the good news. The bad news is that the vast majority of Ukraine's 300 privatization certificate investment funds are holding shares in thousands of enterprises for which there is little or no market, i.e. the funds hold illiquid shares in enterprises which are at best marginally attractive or, at worst, de facto bankrupt. For the many investment funds which did not pay citizens cash for their PPC's - but issued shares in the fund, the termination of these closed end funds means that investors will be unable to cash out. The funds will be unable to liquidate their portfolios, particularly given current market conditions. In other words, these funds will go bankrupt with their investors receiving no compensation. It is therefore critical that the Securities Commission accelerate its efforts to consolidate the many weak funds with the few strongest - before the collapse of the former.
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Following are the key external events which impacted Ukraine's privatization program and the key outputs for the month, listed by team:

Privatization Strategy/Policy Consulting and Data Analysis Team Key Events and Key Outputs:

- * The Cabinet of Ministers approved 90 more share allocation plans of ex-"Khib Ukrainy" enterprises; the total number of approved plans is now 346 out of 442 ex-KU enterprises.
- * Met with the State Anti-Monopoly Committee (AMC) to discuss possible cooperation in efforts for demonopolization of para-statal holding companies in the Agro-Industrial Complex (AIC). Took part in roundtable discussion with the AMC sponsored by the editorial board of "Business" newspaper.
- * On May 22, AMC issued an Order announcing that Khib Ukrainy had violated Ukraine's anti-monopoly legislation by operating as a monopolist in the regional grain markets of Dnipropetrovsk (where its group of enterprises control 36.6% of the market), Lugansk (49.7%), L'viv (35.2%), Mikolaev (61.5%), Kharkiv (45.2%), Kherson (53%) and Cherkassi (50.9%). The AMC fined Khib Ukrainy UAH 30,000 for these violations.
- * Delivered presentation on AIC demonopolization and elevator privatization at a large gathering of private investors, domestic producers, consulting firms and donor organizations which was held by the new Minister of AIC, Boris Suphikhanov, and Vice Prime Minister Tyhypko to discuss the state of the agricultural sector in Ukraine and ways to accelerate its development.
- * At the request of the Inter-Ministerial Commission for Agrarian Reform (IMCAR), drafted legal analysis and comments on new draft changes to #1218 Cabinet of Ministers Resolution on Khib Ukrainy, which calls for the removal of 18 elevators from the list of elevators to be privatized and the transfer of their assets to the statutory fund of Khib Ukrainy. This would increase the number of elevators owned by KU to 115, thus exceeding the figure of 100 elevators agreed upon by the Kuchma-Gore Commission and the World Bank and IMF. These changes have yet to be officially approved as a new Cabinet of Ministers Resolution, although a draft has been sent to the Prime Minister for his approval.
- * Assisted the SPF in revising proposed changes to the "Law on Peculiarities of AIC Privatization." The most significant of proposed changes would reduce the period for preferential share sales to employees from one year to six months.
- * Completed an analysis of various monopolistic, "parastatal" structures and associations in the agro-industrial complex. No less than 40 associations, "unions," corporations and conglomerates are active in all areas of the agro-industrial complex, including Khib Ukrainy, Ukragrotekhservice, Ukragrokhim, and Ukragromashinvest.
- * At the request of the Ministry of AIC, drafted answers to commonly asked questions on grain elevator privatization.
- * Participated in the meeting of donors and contractors on AIC reform issues conducted by CNFA. Made presentation on grain enterprise privatization.
- * The Verkhovna Rada has approved a Resolution extending PPC and CC distribution for an unspecified period of time. Nevertheless, the Savings Bank halted PPC and CC distribution as of the 1st of July referring to the absence of any executive order from the Cabinet of Ministers requiring them to continue distribution.
- * The regulation, implementation instructions and software for conducting the specialized mass cash auctions were developed by us and approved by the SPF.
- * The first mass cash auction for the sale of 102 companies, including two energy distribution companies, has been launched. 260 companies have been planned for offering at the 2nd auction in August.
- * In spite of the requirements of the 1998 Privatization Program which allowed for share sales at the price below nominal value, the Cabinet of Ministers refused to approve amendments to the Cabinet's Resolution #218 which introduced this provision for the PPC auctions. The SPF took

the risk to approve results of the 39th PPC auction using the new procedures - without awaiting Cabinet approval.

- * The Cabinet halted the privatization of four energy generating companies at the request of the Ministry of Energy.
- * Our draft Telecommunications Privatization Law has been returned by the Cabinet to the Communications Committee for redrafting.
- * Prepared information for the World Bank EDAL evaluation mission on the status of the Bank's conditionalities and took part in the negotiations between the Bank and the SPF.
- * Drafted letter from the US Ambassador to the President of Ukraine on the issue of Dershinvest and Finprom (state owned investment companies) roles in privatization using undistributed CCs.
- * Met with UMREP to discuss the common strategy of the Mass Privatization Program's final phase propaganda campaign. Proposals regarding the agendas for the Press Clubs and radio programs have been prepared.

Agro-Industrial Complex (AIC) Consulting Team Key Outputs:

- * Advised the SPF in the preparation of amendments to be proposed to the Law on AIC Privatization.
- * Completed a new manual on preferential share sales to agricultural suppliers.
- * Prepared an analysis of AIC holding companies and associations and drafted proposals for their restructuring and liquidation.
- * Conducted seminars on tenders and stock exchange sales and free transfer procedures for 71 ex-Khlib Ukrainy elevators in Ivano-Frankivsk, Kharkiv, Mykholayiv and Kherson regions.
- * Conducted a "train the trainers" seminar on enterprise preparation for privatization policy and procedures for 20 consulting firms in Zaporizhye region.
- * Provided direct technical assistance for privatization plan preparation, valuation, share emission registration, and other privatization preparation projects for 79 ex-KU elevators.
- * Assisted in the preparation and delivery to certificate auctions (42nd PPC auction, 28th CC auction, 2nd Mass Cash auction) documents for the sale of share packages for 528 enterprises.
- * Verified the fixed asset values and privatization status of Ukraine's 200 largest strategic enterprises.
- * Consulted seven "giant" enterprises on various enterprise preparation issues.

Ukraine Privatization/Investment Web Site Team Key Outputs

- * The Mass Cash Auction Regulations and Procedures were added - in Ukrainian and English - to the site.
- * Updated data on electric power sector enterprises (tenders, stock exchanges sales, certificate auctions, share allocation plans).
- * Updated data on privatization of the agro-industrial sector.
- * Updated the list of nearly 9000 enterprises privatized (70% sold) to date since January 1992(as of June 26, 1998).
- * Added the latest certificate auction results and auction analyses.
- * Created a new section on the site - "Cash Auction Statistics".
- * Created links to web site tender announcements for 21 enterprises.
- * Expanded web site linkages with the World Bank's "Privatization Link" web site.
- * The number of visits to the web site increased to between 200 to 400 per day (with 70% of visits to the English version and 30% to the Ukrainian version of the site).

Information Technology Team

- * Completed development and testing of the data entry software for mass cash auctions, delivered it to the SPF management for official transfer to the Auction Center Network.
 - * Continued development and testing of the mass cash auction data consolidation, verification and calculation software for the Auction Center Network.
 - * Delivered the software to the SPF IT specialists for detailed testing.
 - * Completed preparation of the manual on data entry procedures for regional auction center managers and operators and delivered it to the SPF management for official transfer to Auction Center Network management.
 - * Continued preparation of the manual on mass cash auction data consolidation, verification and auction calculation software for Auction Center Network.
 - * Started development and testing of the mass cash auction data consolidation and verification software for the regional auction centers.
 - * Implemented joint SPF/PW maintenance of auction systems. Maintenance of auction calculation systems is the only remaining PW responsibility.
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JULY 1998 PROGRESS REPORT

Post-Mass Privatization Project: New GOU Initiatives and Proposals

Officials of the Cabinet of Ministers (Vice Prime Minister Tyhypko's team of advisors) have indicated that they propose to ask the international donors for technical assistance for the continuation of components of the USAID mass privatization program (MPP) project beyond conclusion of the project in the fall. They have indicated that technical assistance for several initiatives will be critical to the Government of Ukraine particularly as the government transitions to the sale to international investors and the post-privatization restructuring of its strategic enterprises and strives to meet IMF EFF and World Bank EDAL II late 1998/1999 privatization and related conditionalities.

The proposal, as explained to us, is to involve a request for limited technical assistance for a team of specialists to serve as Private Sector Development advisors to the Cabinet of Ministers' rejuvenated Inter-Ministerial Council for Economic Reform, led by Vice Prime Minister Tyhypko, as well as the State Property Fund. Assistance will be requested for the following projects currently being undertaken by the USAID MPP project:

- Privatization strategy, policy and legal advice in the development, for example, of the 1999 Privatization Program and new privatization/post-privatization strategies and related legislation and regulations;
- Advising and assisting the State Property Fund and the Cabinet in the development of procedures for the implementation of the recently adopted international advisor tender regulations and the related regulations for the sale via tender of strategic enterprises – while transferring skills to State Property Fund counterparts which will allow them to professionally conduct effective and transparent international tenders;
- Privatization data analysis and research to provide the GOU (and the international donors) with the means to independently monitor and influence, in a timely and accurate manner, the progress of Ukraine's privatization program;
- Expansion of the bilingual Ukraine Privatization and Investment Web Site to include more in-depth and accurate reporting on investment opportunities for both potential international and domestic investors.

The Cabinet and the State Property Fund are also requesting additional consulting support for the GOU's Khib Ukrainy/grain enterprise (and other agro-industrial holding companies/monopolies) privatization and demonopolization program beyond the fall.

In addition to these areas in which the USAID MPP project is currently providing policy and implementation advice and assistance, the Vice Prime Minister's advisors are also proposing technical assistance for such areas of private sector development as foreign direct investment promotion, enterprise restructuring assistance, enterprise corporate governance legislation, and enterprise bankruptcy and liquidation.

Transfer of Compensation Certificates to State Investment Companies:

- The Parliament failed to approve measures to prevent the implementation of the President's Decree which provides for the transfer of all uncollected Compensation Certificates to the state

investment companies, Derzhinvest and Finprom (both managed by the Ministry of Industrial Policy). The Parliament agreed to postpone discussion regarding the future use of Compensation Certificates until September.

- As a result, the President's Decree and the Cabinet's implementation resolutions are to be implemented in August.
- The national Savings Bank and Oranta, the state insurance company, are preparing for the book transfer by August 10 of all uncollected Compensation Certificates (as of the July 1 deadline for public collection) to Finprom and Derzhinvest, respectively.
- To implement the President's Decree, the Cabinet has ordered the State Property Fund (SPF) to prepare to offer up to 25% share packages (from the shares currently allocated to state ownership) in each of 93 of the 399 "blue chip" enterprises on the Cabinet's list of enterprises to be offered in Compensation Certificate auctions during the months of August – December 1998.
- The SPF is now therefore revising the share allocation plans of these 93 enterprises (from the chemical, metallurgy, steel, pipeline manufacturing, machine building, farm equipment, pharmaceutical, and ball bearing industries – including such giant enterprises as "Turboatom" and "Motor Sich") in order for the 25% share packages in each enterprise to be offered in the August Compensation Certificate (CC) auction.
- In order to give the SPF the time to revise these share allocation plans and to give Finprom and Derzhinvest the time to auction the CC's to financial intermediaries, the August CC auction will begin on August 22, one week later than the established mid-month starting date.
- The plan is for the SPF/GOU to publicly announce that exceptionally large share packages in very attractive enterprises will be offered in the August CC auction. This will drive the secondary market price for CC's to a level above the CC face value of UAH 10 (from the current market price of UAH 1.5). Which will in turn allow Finprom and Derzhinvest to sell a large volume of CC's to financial intermediaries prior to the August CC auction, thus generating significant new revenues for the GOU.
- At this point in time, it appears that Finprom/Derzhinvest's involvement may end here and that the state share packages offered in the CC auctions will be sold to real investors/investment funds – and not indirectly (through intermediaries) to Finprom/Derzhinvest.
- If so, this plan will still represent a regressive step in terms of the transparency of Ukraine's privatization program. If the GOU is indeed serious about raising revenues for the budget, the much more logical and greater revenue generating initiative would be to sell the state share packages of the 93 – and all 399 "blue chip" enterprises - for cash via tenders and/or stock exchange sales.

Positive Developments in Privatization of the Electric Power ("Energo") Sector:

In the electric power sector, there were several major developments during July:

Seven (out of 10 concluded to date) cash tenders for large share packages (percent of shares sold indicated below) were concluded in July for the following regional electric power distribution companies ("oblenergos"):

- SumyOblenergo, 36%
- ChernigivOblenergo, 35%
- PrikarpatyyaOblenergo, 35%
- OdesaOblenergo, 35%
- LvivOblenergo, 35%
- LuhanskOblenergo, 36%
- PoltavaOblenergo, 35%

Each winning bidder has been offered the option of negotiating a contract with the SPF to manage the 25% state share package in each oblenergo. We have initiated discussions with the SPF regarding the use of the newly drafted Management Contract as the model for use in place of the SPF's current seriously flawed (and unused to date) management contract.

The bidding period for these tenders was extended from 30 days to 60 to 90 days, giving potential bidders additional time to conduct due diligence.

Per a Cabinet of Ministers Resolution of August 5, 1998, the state shareholdings in all Oblenergos have now been reduced from 51% to 25%+1 share. The ex-state share packages have been allocated to cash tenders. Meaning that investors will have the opportunity to buy from 35% to 45% of the shares of each Oblenergo in cash tenders – in addition to the 30% to 35% of shares which strategic investors might purchase via local stock exchange sales and in the secondary market.

GOU progress in implementing the privatization tasks (components #17 - #20) of the Power Sector Financial Recovery Plan as of late July is as follows:

17. *SPF to develop new Contract for the Management of State Shares by winners of oblenergo and genco tenders by July 1, 1998.* At the request of the SPF management, we have completed drafting of a new standard Management Contract for review and consideration by the SPF in August. *Transfer management rights to winners of tenders beginning in July 1998.* The SPF has offered the right to manage state shares to the winners of the seven oblenergo commercial tenders concluded in July. However, management contracts will not be concluded until purchase and sale agreements are concluded by the SPF and the winning bidders.

18. *Tenders for at least 25%+1 share in each of 15 oblenergos to be completed by Jan 1, 1999.* Winners have been announced (i.e. tenders have been concluded – although purchase/sale agreements have yet to be concluded for the July tenders) for 10 oblenergo tenders to date ranging in size from 12% (for a tender concluded in Jan 1997) to 20% (for two tenders concluded in March 1998) to 35% or 36% (for the seven tenders announced in July) of the shares of each oblenergo. *Complete the sale of all 27 oblenergos by July 1, 1999.* An average of 40% of the shares of each oblenergo (ranging from 16% to 73%) have been sold to date by all means of sale (preferential share sales to employees, certificate auction sales to the public, tenders, stock exchange sales, and cash auctions). Depending upon market conditions, we expect that all oblenergos will be privatized (i.e. 70%+ of the shares of each sold) before the end of the first quarter of 1999.

19. *Hire international advisor for the sale of 24% of Tsentrenergo by May 15, 1998.* Winner of competition to select international advisor was announced in the spring. Negotiations over terms of contract continue. *Hire international advisor for the sale of 24% of Zakhidenergo by July 1, 1998.* A tender for the selection of an advisor for Zakhidenergo has yet to be announced. A tender for an international advisor for the sale of 24% of Donbasenergo was held seven months ago. The winner of the tender and the SPF continue to negotiate terms of the contract.

- NOTE: The tenders to hire advisors for Donbasenergo and Tsentrenergo were conducted by the SPF utilizing the December 1997 tender regulation which required that the winner provide bridge financing to the GOU. This “pre-privatization” financing issue has delayed conclusion of agreements with the two advisors.
- Once contracts have been concluded, the advisors should utilize the newly adopted international tender regulation for the sale of 24% each of Donbasenergo and Tsentrenergo to strategic investors.

- Dniproenergo, having seen the delays encountered by Donbasenergo and Tsentrenergo, plans to have the SPF conduct an investment tender for its 25% share package without the use of an advisor and through the use of the existing non-commercial tender procedures (not the new international tender regulation).
- Thus leaving Zakhidenergo as the only generating company which might utilize both the newly adopted tender for international advisor regulation and the international tender regulation.
- Whether the four gencos will utilize, if adopted by the SPF and Min Energo, the newly drafted standard management contract to allow strategic investors to manage the state's 51% shareholdings is uncertain at this point in time.

20. *Prepare initial draft of 1999 energo privatization plan for consideration by Cabinet of Ministers by Oct 15 and final draft by Nov 15, 1998.* Status = N/A (both dates lie beyond the end date for our project).

Following are the Key Events which influenced Ukraine's privatization program and the Key Outputs of the Mass Privatization Project Team during the month of July:

Privatization Strategy, Policy and Procedures Consulting Team:

- The policy team was actively involved in both gathering information on the Compensation Certificates to Derzhinvest/Finprom scheme during the month and in providing analyses as to the impact of the plan to both GOU counterparts and the international donors.
- The management of the SPF requested our assistance in drafting the 1999 privatization program. However, given that key GOU counterparts will be on vacation during much of August and that our project ends in the fall, we have indicated that we will most likely be unable to assist.
- The new, donor-supported/consultant-drafted Tender for International Advisors Regulation and the related Tender for Strategic Enterprises Regulation were registered by the Ministry of Justice on July 3.
- Our draft of the Law on the Privatization of Ukrtelecom, which had been informally agreed with the State Communications Committee, has been severely revised in the version informally adopted (i.e. it still requires review by the Cabinet's legal department and the signature of the Prime Minister) by the Cabinet of Ministers last week for presentation to Parliament. What had been a comprehensive document providing for transparent privatization according to established privatization legislation now reads as through written by a committee whose members have competing and alternative privatization strategies.
 - On the positive side, the Cabinet's draft does provide for at least 25% of shares to be sold to a strategic investor, for the preferential sale of shares to Ukrtelecom's 130,000 employees for cash (the use of privatization certificates will end on December 31), for other share sales via stock exchanges and cash auctions, and require an international audit and valuation of the company prior to privatization.
 - On the negative side, the Cabinet's draft (while allowing for the sale of 100% of shares ex-one share), includes a state "golden share". The conditions attached to the golden share allow the state to appoint a minimum of 50% of the members of the Supervisory Board and the Revision (audit) Commission – no matter what the size of the state's shareholding and to veto any decision of the Board. The Cabinet's draft also requires that Ukrtelecom complete the process

of corporatization prior to privatization (our draft allowed Ukrtelecom to privatize without the lengthy corporatization process.)

- It is very likely that the Parliament will prepare its own Ukrtelecom privatization law and that the final version adopted by the Parliament will be an amalgam of the interests of the Cabinet and Parliament.
- There is still time for the international donors/consultants to promote a more comprehensive law which will be more likely to attract international strategic investors.
- With input from World Bank consultants, representatives of the EBRD and other parties, we completed drafting of a standard Contract for the Management of State Shares to be used by the winners of tenders who are given the option of managing remaining state shareholdings in the enterprises in which they have invested.
- We worked with other USAID consultants and representatives of the IFC and international investment funds to learn of problems regarding secondary share emissions by enterprises in the process of privatization. As a result of these discussions, we are now drafting new regulations for the SPF to govern increases in the capital of privatizing enterprises which result from the allocation of additional state assets to such enterprises. The draft regulations will provide for a pro rata share distribution of new shares to all existing shareholders in such cases (as opposed to new shares going only to the state with the subsequent dilution of other shareholders).
- Completed final drafting of the Zakhidenergo (one of Ukraine's four electric power generating companies) Corporate Charter which is to be presented for adoption to the company's first shareholders' meeting in September.
- Final revisions were prepared and implemented for the first Mass Cash Auction via the Auction Center Network.
- Reviewed and prepared and distributed a legal analysis of the Presidential Decree on Compensation to Citizens for Lost Savings (the Finprom/Derzhinvest Compensation Certificate plan).
- Updated the Share Registration "How To" Manual for enterprises in the process of privatization in order to reflect recent changes in regulations.
- Participated in the drafting of the new enterprise valuation procedures adopted by the SPF.

Privatization Data Analysis and Research Team:

- Updated all privatization databases including the Khib Ukrainy, Agro-Monopolies, Energos, PPC Auction, CC Auction, Stock Exchange Sales, Tenders (18 out of 208 successfully concluded over the past 12 months), Mass Cash Auctions, and "Top 200" databases – which are provided to the SPF and are available to the public (including domestic/international investors) and the international donors via the "*Ukraine Privatization and Investment Web Site*".
- Results of Ukraine's first Mass Cash Auction for the sale of leftover state shares via the Auction Center Network: 1900 firm bids, all share packages offered were sold, UAH 2.47 million received (UAH 245 million in privatization revenues for the budget have been generated in total by the SPF in 1998 through mid-July).
- 3 Khib Ukrainy grain elevator tenders were successfully concluded. 18 were unsuccessful and second round tenders (with reduced minimum prices) are now being conducted. If unsold in the second round, per regulations, these shares must be offered for sale by other means (stock exchanges, certificates, mass cash auctions). Why have these grain elevator tenders not been more successful? Because the starting prices are too high (from 1.2 to 12 times book value), it is cheaper to buy shares in the secondary market from employees and agro suppliers (collective farm employees), most of the elevators are in very poor condition and highly unproductive – thus

the primary reason for investor interest is to tear down the elevators and build new elevators if the sites are strategically located near rail and/or port facilities.

- Completed analysis for the SPF of the SPF “Plan Graphic” to reach 9500 medium and large enterprises privatized target (per IMF EFF conditionality) by Dec 31, 1998. To implement the plan, the SPF has ordered all of its regional offices to privatize – by any means – the enterprises which will allow the SPF to meet the year end target.
- 7800 medium and large enterprises verified by us as privatized (since Jan 1995) as of mid-July 1998.

Agro-Industrial Complex (AIC) Privatization/Demonopolization Consulting Team:

- Our draft of the amendment to the Cabinet of Ministers’ Resolution #1218 was signed by the Ministry of Agriculture and Khib Ukrainy and approved by Vice Prime Minister Tyhypko. The amendment orders the sale of all (100%) remaining state shareholdings in all 442 ex-Khib Ukrainy enterprises.
- As of late July, 96 ex-Khib Ukrainy (“Bread of Ukraine” grain storage monopoly) enterprises had been privatized, 130 had begun share sales, and 365 share allocation plans had been approved by the Cabinet.
- We conducted an ex-Khib Ukrainy “Accelerating Grain Enterprise Privatization” training seminar in Ternopil. 70 representatives of ex-Khib Ukrainy enterprises, the Ministry of Agriculture, the Anti Monopoly Commission, the regional SPF and the regional government administration attended the seminar.
- “Accelerating Privatization” (step-by-step, “how to”) training seminars were also held during the month for 33 ex-Khib Ukrainy enterprises in Dnipropetrovsk, 12 enterprises in Lviv, 9 in Zaporhizhya, and 15 in Luhansk.
- We prepared contracts for the accelerated “free transfer” of shares to agro suppliers for 30 ex-Khib Ukrainy grain elevators in order to accelerate their privatization.
- In addition, 49 large agro-industrial/ex-Khib Ukrainy enterprises were provided with technical assistance to complete valuations, draft privatization plans, prepare documents for share registration, prepare documents for stock exchange sales, complete free transfer agreements, and prepare corporate charters.
- A “train the trainers” general enterprise preparation seminar was held for 20 local consulting firms and local officials involved in preparing enterprises for privatization in Zaporhizhya during the month.

Ukraine Privatization and Investment Web Site Team:

- 20 tender announcements per month are being translated and added to the web site (in Ukrainian and English).
- The web site contains 17 megabytes of information making the site one of the largest in Ukraine.
- 300 international and domestic parties per day on average are now accessing the web site.
- The SPF’s server is now being utilized to enhance internet access and to further involve the SPF in maintenance of the web site.

Information Technology Team:

- Our IT team developed and delivered to the SPF and the Auction Center Network – on time – the final Mass Cash Auction software and related training manuals which allowed the GOU to successfully conduct its first such auction in July.
- The software was delivered by us on July 1 with revisions to the program made over the following few days.

- The software for mass cash auction data consolidation from the regional auction centers and for verification by the UCCA (auction center network headquarters) and the SPF was delivered to the UCCA/SPF on July 8.
- On July 24, the UCCA/SPF ordered changes in the mass cash auction data entry software. We developed and delivered the revised software to the UCCA/SPF one week later.

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